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**REPORT TO  
THE CONGRESS OF THE UNITED STATES**

**EXAMINATION OF  
ECONOMIC AND TECHNICAL ASSISTANCE PROGRAM  
FOR KOREA  
INTERNATIONAL COOPERATION ADMINISTRATION  
(SUCCEEDED BY AGENCY FOR INTERNATIONAL DEVELOPMENT)  
DEPARTMENT OF STATE  
FISCAL YEARS 1957-1961**

**PART I**

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Comptroller General of the United  
States, Washington, D.C. General  
Accounting Office  
Examination of economic and tech-  
nical assistance program for Korea,  
International Cooperation Administra-  
tion(succeeded by Agency for Inter-  
national Development), Dept of  
State, fiscal years 1957-1961, report  
to the Congress of the United States.

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**BY  
THE COMPTROLLER GENERAL OF THE UNITED STATES  
SEPTEMBER 1962**

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COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON 25

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To the President of the Senate and the  
Speaker of the House of Representatives

Herewith is the report on our examination of selected activities of the economic and technical assistance program for Korea for the fiscal years 1957 through 1961. During this period the program was administered by the International Cooperation Administration (succeeded by the Agency for International Development), Department of State.

For the period covered by our examination (1957-61), the program for Korea was the largest individual country program for economic and technical assistance financed under the Mutual Security Act of 1954. Total aid obligated from mutual security funds, including loans (\$22 million) from the Development Loan Fund, aggregated close to \$1.2 billion for the 5-year period. This aid was supplemented by more than \$250 million worth of surplus agricultural commodities made available under Public Law 480.

Measured in relation to this financial outlay the progress achieved in the economic development of Korea was considerably less than was reasonable to expect. A variety of interconnected causes account for this disparity. At the center of these causes were (1) a level of aid (averaging more than \$200 million annually) which the Korean economy could not absorb productively nor the Korean Government administer efficiently, (2) limited technical skills in Korea, and (3) failure of the responsible United States agencies to recognize sufficiently these limitations in the annual programming of aid. The availability of such relatively large resources was a disincentive to fiscal prudence and tended to encourage personal and governmental standards out of proportion to economic realities.

The more specific causes of the program's poor economic showing are summarized in part I and further described in part II of the accompanying report. They are attributable mainly to deficiencies in certain sectors of the Korean economic structure, lack of cooperation by the Korean Government, and poor program planning and administration by ICA. These causes deal with areas of the Korean economy, the betterment of which is vital to Korean economic development

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and the success of the aid program. We believe that only if these causes are eliminated or greatly minimized is it logical to expect that economic development in Korea and the productive utilization of aid funds through better administration will be attainable in any degree reasonably commensurate with the amount of aid.

The agency although not agreeing with all aspects of our findings has expressed the over-all view that our report represents a competent study of the Korea program and that our recommendations are in accord with the agency's policy although some of them will not prove readily feasible. The agency has further advised us of certain actions under way or to be taken to strengthen the effectiveness of the program. The substance of the agency's comments, the actions taken or planned by it, and the measures recommended by us as to the individual matters discussed in our report are included in the respective sections of the report.

The aid level for 1962 was reduced to \$125.7 million, which brings the aid program within more manageable financial dimensions. This and other events described on pages 9 and 10 of our report offer the basis for redirecting the aid program toward the more expeditious and less costly attainment of its economic goals. The accompanying report is intended to help point the way toward such redirection.

Copies of this report are being sent to the President of the United States; the Secretary of State; and the Administrator, Agency for International Development.



Comptroller General  
of the United States

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REPORT ON EXAMINATION  
OF  
ECONOMIC AND TECHNICAL ASSISTANCE PROGRAM  
FOR KOREA  
INTERNATIONAL COOPERATION ADMINISTRATION (note 1)  
DEPARTMENT OF STATE  
FISCAL YEARS 1957 - 1961

INTRODUCTION

The General Accounting Office has examined the United States economic and technical assistance program for Korea for the fiscal years 1957 through 1961 as administered by the International Cooperation Administration (ICA) of the Department of State under the authority of mutual security legislation. This examination was made as a part of a continuing audit of selected activities of the mutual security program, pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67), and was a follow-up on an earlier examination of the aid program in Korea for fiscal years 1954 through 1956. (See report to the Congress, B-125060, dated June 24, 1957.)

Our examination was directed principally to a review of the administration of selected activities and was made at the Washington office of ICA and at the agency's operations Mission in Korea

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<sup>1</sup>Succeeded by Agency for International Development (AID), pursuant to Executive Order 10973, dated November 3, 1961. Since AID did not succeed ICA until after the period covered by our examination, we refer to ICA as the administering agency.

(referred to in this report as the "Mission"). The scope of this examination is further described on page 157.

The General Accounting Office has also issued separate reports on the responsibilities of the Department of Defense under the military assistance program (MAP) for Korea.<sup>1</sup>

The officials primarily responsible for the administration of economic and technical assistance for Korea starting with fiscal year 1957 are shown in the appendix to this report. (See p. 169.)

The ICA program in Korea was reviewed by the Office of the Inspector General and Comptroller, Foreign Assistance, Department of State, and a report was issued in January 1961. A copy of this report was made available to us toward the end of our field review.

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<sup>1</sup>See audit reports to the Congress on review of the military assistance program for Korea (B-125099) dated October 4, 1957, February 26, 1960, and January 31, 1961 (classified "Secret"), and June 8, 1962 (classified "Confidential").

## DESCRIPTION OF AID PROGRAM

### NATURE AND OBJECTIVES

United States economic assistance to Korea from the end of the Japanese occupation in 1945 to the start of the current program in 1954 totaled more than \$1 billion, administered under several separate programs.

The current economic assistance program began in fiscal year 1954, after termination of the Korean hostilities, under the administration of the Foreign Operations Administration (FOA), predecessor agency of ICA, and has continued under ICA and its successor, the Agency for International Development.

The objectives of the ICA program in the 1954-56 period (covered by our prior report) were basically to reconstruct war damage and to assist in maintaining Korean military forces. Assistance was given to finance reconstruction and improvement projects, with major emphasis on essential utilities and transportation services. Substantial amounts were also made available for the rehabilitation of existing industries and for establishing a new industrial base. In addition, through the commodity import program, essential commodities such as food, fertilizer, and raw materials needed to maintain consumption levels were imported, and the local currency proceeds were used to support the Korean military budget and for local costs of rehabilitation projects. During 1957, the rehabilitation effort was largely completed and pre-Korean-war living standards were restored or exceeded.

The stated objectives of the program in the 1957-61 period, covered by this report, were to help maintain essential consumption by importing food, fertilizer, and essential raw materials and, through the use of the local currency proceeds derived from these imports, to help maintain Korean military forces through support of the Korean military budget. In addition, the ICA program was designed to strengthen the basic structure of the Korean economy so that the country could provide a larger share of its requirements from domestic production.

Direct United States economic assistance to Korea since the end of the Korean war is summarized below:

|  |                  | Obligations at<br>June 30, 1961 |                         |
|--|------------------|---------------------------------|-------------------------|
|  |                  | Fiscal years                    |                         |
|  | <u>Total</u>     | <u>1954-56</u>                  | <u>1957-61</u>          |
|  |                  | (millions)                      |                         |
| ICA and predecessor agency:                    |                  |                                 |                         |
| Commodity imports                              | \$1,342.7        | \$425.1                         | \$ 917.6                |
| Project assistance                             | 504.6            | 290.7                           | 213.9                   |
| Cash grant                                     | 20.0             | -                               | 20.0                    |
| Overseas administration                        | 9.5              | 2.1                             | 7.4                     |
| Emergency relief and assistance                | 9.0              | 9.0                             | -                       |
| Ocean freight on voluntary<br>agency shipments | <u>4.8</u>       | <u>2.7</u>                      | <u>2.1</u>              |
| Total  | <u>\$1,890.6</u> | <u>\$729.6</u>                  | <u>\$1,161.0</u>        |
| Development Loan Fund:                         |                  |                                 |                         |
| Development loans                              | <u>\$ 22.0</u>   | <u>-</u>                        | <u>\$ 22.0</u>          |
| Public Law 480:                                |                  |                                 |                         |
| Title I  | \$ 214.6         | \$ 61.7                         | \$ 152.9                |
| Title II                                       | 28.4             | -                               | 28.4                    |
| Title III                                      | <u>104.5</u>     | <u>28.7</u>                     | <u>75.8<sup>a</sup></u> |
| Total  | <u>\$ 347.5</u>  | <u>\$ 90.4</u>                  | <u>\$ 257.1</u>         |
| Department of Defense:                         |                  |                                 |                         |
| Armed forces assistance to<br>Korea            | <u>\$ 27.9</u>   | <u>\$ 22.0</u>                  | <u>\$ 5.9</u>           |

<sup>a</sup>Data for 1961 not included.

The armed forces assistance program to Korea, started in November 1953, has been administered by the United States Army and has consisted generally of rebuilding schools, public health facilities, orphanages, and similar civil structures.

#### INDIRECT AID

The Korean Government received substantial indirect aid in the form of profits on the resale of dollars received from the United States for purchases of local currency for United States/United Nations (US/UN) forces and for goods and services procured locally by these forces and the ICA Mission. The purchases were made at the official rates of exchange, and the dollars so obtained were resold by the Korean Government at rates generally at least double the official rates. From 1955 to 1960, purchases of local currency and of goods and services amounted to \$113 million and \$93.5 million, respectively, exclusive of utility services which in 1959 (the only year for which the cost was readily determinable) totaled \$13.1 million.

These forms of indirect aid ceased in February 1961 when the exchange rate was established at 1,300 hwan to \$1.

#### LOCAL CURRENCY

Local currency (hwan), which was made available to support the Korean military budget and for the local costs of technical cooperation and economic development projects within Korea, was derived from:

1. Commodity imports financed by ICA under the mutual security program.

2. Proceeds from the sales of surplus agricultural commodities under section 402 of the Mutual Security Act of 1954 and under title I of Public Law 480.

One of the major purposes of local currency has been to support the very large Korean military forces under a program designated as Local Currency Military Budget Support. This program is administered by the United States Military Assistance Advisory Group (MAAG) in Korea. A total of 251.6 billion hwan had been allocated to this program through December 31, 1960, from the three sources of local currency.

Substantial amounts of counterpart funds were loaned to public and private entities for the development and expansion of various sectors of the Korean economy. At December 31, 1960, counterpart funds released to three Korean Government banks for loan purposes amounted to 112.6 billion hwan, most of which was administered by the Korean Reconstruction Bank.

#### ADMINISTRATION OF THE PROGRAM

##### Bilateral agreements

During the period covered by our examination, the economic and technical assistance program for Korea was carried out under (1) an economic aid agreement dated December 10, 1948, and ancillary agreements (described in detail in our prior report) and (2) a comprehensive aid agreement dated February 8, 1961, which, with one minor exception, superseded the previous agreements.

##### United States Operations Mission

The ICA program in Korea has been administered by the United States Operations Mission in a manner similar to that in which ICA



operations in other countries have been administered. In 1959 the Mission superseded the Office of Economic Coordinator (OEC), United Nations Command, which had administered the civilian relief program of the United States Army and then the ICA program. In keeping with the transfer of responsibility for the ICA program from OEC to the Mission, the line of communication, which under OEC had been through the Commander in Chief, United Nations Command, was transferred to ICA channels.

At the time of our field audit, the Mission employed 257 Americans and 1,059 Koreans. In addition there were 173 Americans and 256 Koreans connected with the United States economic assistance program under ICA financed or administered contracts with professional, educational, and voluntary organizations.

#### Combined Economic Board

The Combined Economic Board (CEB), composed of the Director of the Mission and the Korean Minister of Reconstruction (MOR), was established in May 1952 as the vehicle for agreement between the United States and Korea regarding all aspects of the aid program including plans and policies and approval of specific activities.

The MOR,<sup>1</sup> which is the Korean counterpart of the ICA Mission, acts as the liaison between ICA and the various Korean ministries and sets forth policies to be followed by those ministries in the conduct of the aid program.

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<sup>1</sup>In May 1961, after the change in government, the Ministry of Reconstruction (MOR) became the Ministry of Economic Development (MED) which in turn was succeeded in July 1961 by the Economic Planning Board.

## SUMMARY OF FINDINGS AND RECOMMENDATIONS

### OVER-ALL OBSERVATIONS

The conditions disclosed by our examination require the conclusion that the aid program in Korea during the fiscal years 1957 through 1961 was considerably less successful in advancing the economic progress of the country than was reasonable to expect from a program of such substantial financial magnitude. A similar conclusion was expressed by the Office of the Inspector General and Comptroller in its report issued shortly before our examination. Further affirmation of this conclusion is clearly evident in the proposed foreign aid program for fiscal year 1962 presented to the Congress by the United States executive branch. This unanimity of judgment from these separate sources demonstrates clearly the urgent necessity of concentrating on the causes which led to this judgment to the end that the program may move toward more satisfying economic results.

The disproportionate success of the program is attributable to several interrelated causes. Most notable in our opinion are that the level of aid, which averaged in excess of \$200 million annually, was beyond the capacity of the Korean economy to absorb productively or of its government to administer efficiently, and was a disincentive to the prudent use of both Korean resources and United States aid funds; that technical skills in Korea were admittedly limited; and that these facts were not sufficiently recognized in the annual programming of aid. We believe that the combination of these causes was the root of the program's shortfall in

economic progress. Moreover these causes undoubtedly aggravated certain basic weaknesses in the Korean economic and political structure, which in themselves handicapped the program. Acknowledged large-scale corruption in Korea and the country's meager experience in government responsibility and administration, together with resulting political instability, weakened the moral fabric of business practice and stultified the growth of the country's economy.

Recent events have afforded the opportunity to remedy the basic causes of the program's retarded economic progress. The establishment of a unitary and more realistic exchange rate in February 1961 should remove the occasion for a variety of abuses in foreign exchange and commodity imports, increase counterpart funds available for economic development, and generally contribute to an environment of confidence and stability. The Revolutionary Government, which came into power in Korea in May 1961, has reported measures taken and to be taken to revive economic activity, overcome extensive corruption in government, and accelerate long-range economic development. Finally the concept of foreign aid advanced by the United States executive branch in the program presentation to the Congress for fiscal year 1962 is designed to provide aid for economic development on the basis of the recipient country's long-range plans, capabilities, and efforts to help itself. This concept and the reported plans of the Revolutionary Government, if faithfully followed, should be conducive to positive steps in Korea toward tax reform, proper and

maximum utilization of the country's resources, and other internal measures that will give impetus to economic strength. These events provide the foundation for a redirection of the aid program in Korea along a more ordered course than it has followed in past years.

This report is addressed principally to those areas of the Korean economy and of the aid program which, because they have not been actively pursued or successfully carried out, have been the main causes or symptoms of causes for the relatively poor economic advancement in Korea and which, because of their basic primacy to the economic development of Korea, will be essential factors in any program of economic assistance in that country. Most of these areas were pointed out in our previous report. They are dealt with in greater emphasis in this report with the particular purposes of encouraging the fullest consideration of them in the formulation of future programs and of stimulating the necessary positive effort toward resolving the problems involved. We believe that only if these problems are resolved is it logical to expect that economic development in Korea and productive utilization of aid funds through better administration will be attainable in any degree reasonably commensurate with the amount of aid.

We further believe that it is important if not essential to reasonable achievement of the objectives of the aid program that the responsible United States agencies take an active part and have a meaningful voice in the policies, practices, and operations of those segments of the Korean economy which bear significantly

on that country's economic stability and development. The annual level of economic aid averaged more than six times the foreign exchange commodity earnings of Korea. Most other foreign exchange earnings have derived from expenditures of United Nations forces which consist largely of United States military and civilian personnel. The availability of such large resources as are represented by United States assistance, in addition to and so greatly beyond the country's own resources, very substantially influenced the direction, discipline, and climate of Korean economic policies and the related actions of the Korean Government. Because of this influence and the sizable dimensions of the United States aid investment, the sound formulation and competent administration of basic segments of the economy, such as the internal budget, the tax system, and the utilization of the country's own resources, are matters of high concern to the United States. In our opinion the present state of Korean political and economic sophistication and the history of the aid program over the past years do not offer any reasonable basis for believing that the formidable task of carrying through the hard internal measures vital to Korean economic development in correlation with the prudent management of aid funds so substantially beyond the normal range of the Korean economy, is within the capability of the Korean Government without cooperative guidance, forceful support, and effective surveillance by the United States.

The aid program was not carried out within the framework of any comprehensive economic plan or geared to specific long-range

objectives. The need for such a plan was recognized by ICA and other United States authorities as well as by the Korean Government. We believe that the aid program suffered from the lack of such a plan. A start toward developing a 5-year plan was made by the Korean Government in 1960, and ICA assisted through a university contract. However, the efforts were not successful, the contract was allowed to expire in May 1961, and ICA had not been able to obtain a suitable replacement at the time we completed our field work. In June 1961 the Revolutionary Government furnished ICA with portions of a draft 5-year economic development plan. In our view the paramount consideration is that whatever plan ultimately evolves should be grounded on sound, reliable, and studied data on the many factors that bear directly on the movement and direction of the Korean economy. Insofar as we could ascertain, it did not appear that much of such data had been compiled or that studies in any depth adequate for decision had been made, which would form solid groundwork on which to formulate a substantive and workable economic plan. Thus we would stress that such plan as may be submitted should be thoroughly examined as to the range, depth, reliability, and logic of its underlying substance.

We believe that the broad considerations noted above, together with the more specific aspects of the program which are summarized below and further discussed in part II of this report, constitute the framework for redirecting the program toward the more expeditious and less costly attainment of its economic goals.

### AGENCY COMMENTS

The agency expressed the over-all comment that in general this report is a competent survey of its activity in respect of the Korean aid program and that the recommendations presented in the report are in accord with AID policy although some of them will not prove readily feasible.

The agency acknowledged defects in the administration of the program but stated its belief that, in the context of the size and scope of United States diversified efforts in Korea, the program has achieved a substantial degree of progress under very trying circumstances.

The agency claims that, since the program was largely one of "defense support" as authorized under the Mutual Security Act of 1954, it was not, by legislative definition, addressed to long-range economic development and that the program achieved for the most part its limited objectives of feeding and housing the needy, maintaining and improving the country's production plant, curbing inflation, and supporting the Korean defense budget. As to the extent that objectives have failed to be totally realized, the agency has pointed to the major problems faced throughout the period: (1) Korea's meager national resources, (2) its pressing population problem, (3) United States political and military policies not always being in line with economic objectives, (4) the chronic problems of corruption and obstructionism on the part of certain Korean Government personnel involved in program implementation,

and (5) Korea's almost total lack of institutional framework essential to aid program implementation, such as an efficient government apparatus, a modern educational system, efficient and reliable banking and credit institutions, a national tax system, and responsible fiscal policies.

The agency informed us that comprehensive studies, recently made by the Mission of basic program goals to conform to the concepts of the AID, point toward realistic development of plans and goals emphasizing tangible self-help features. According to the agency, development is only now an actual as well as reasonable program objective. The agency also stated that in the fall of 1961 arrangements were undertaken with a contractor to assist the Korean Government in its long-term planning efforts and in improving and implementing its somewhat unrealistic and overambitious 5-year plan published in mid-1961.

The agency expressed agreement that the United States should exercise its influence in shaping economic policy of the Korean Government but cautioned against extension of this influence to detailed operations or to areas not directly related to the purposes of the aid program.

The major problems to which the agency referred, above, are among the subjects discussed in this report, together with recommended actions to overcome or alleviate them.

We cannot agree with the agency that because the program was largely one of defense support it was not adaptable to long-range economic development. One of the declared objectives of the



program was to strengthen the basic structure of the Korean economy. Defense support no more than "supporting assistance" as authorized by The Foreign Assistance Act of 1961 precluded long-range economic development within the framework of applicable law. Major development projects financed from defense support funds over a number of years constituted a significant portion of the total program. Moreover, the annual program presentations to the Congress and related testimony referred to the long-term character of the aid program. We believe that these circumstances offer convincing evidence that an integrated long-range economic development plan was feasible during the period covered by our examination.

## PROBLEMS IN KOREAN ECONOMIC STRUCTURE

### Need for more productive utilization of Korean resources (p. 67)

Our examination indicated that Korea's utilization of its foreign exchange and productive capability in agriculture and industry, and its administration of civil government operations were not conducive to solid economic development and in some cases were inconsistent with known Korean capabilities or United States agreements or wishes.

Korea did not comply with United States-Korean agreements calling for close coordination in the use of Korea's foreign exchange resources. Korean foreign exchange (1) was used for purposes deemed unwise by ICA (2) was not used for specific commodities which Korea needed to purchase, or (3) was not spent at all and thereby served to add to Korean foreign exchange reserves which increased by \$87 million between December 1955 and July 1961, or 90 percent over the 1955 level.

To a significant extent aid funds under the economic and military assistance programs were used to import commodities which could have been produced in Korea. Failure to utilize this productive capacity caused higher dollar costs to the United States than were necessary. Imports of cotton under the ICA aid and Public Law 480 programs and soybeans under both the ICA and the MAP programs have been responsible in large measure for reducing Korean production of these commodities. ICA and MAP discontinued the financing of soybean imports with United States funds, but financing

of cotton imports continued at high levels. Furthermore, the MAP program was financing the purchase of commodities for the Korean military forces which could be produced by Korean industry. Increased procurement from Korean sources would assist in the development and stimulation of local industry, which has been a major objective of the mutual security program in Korea.

Because of the aid program the United States has a direct interest in the use that the Korean Government is making of its own local currency revenues, including the degree of economy with which governmental operations are carried out. ICA officials reported that the Korean Government resisted any efforts to review or influence the preparation of the civil budget. United States military authorities review and advise on the formulation of the Korean military budget.

The agency agreed that the build-up of Korean foreign exchange, particularly in the past year, was a matter of concern and stated that it had been discussed with the Korean Government in connection with funds for the 1962 program. According to the agency its actions to obtain greater Korean cooperation in the expenditure of Korean foreign exchange were limited by various considerations which we do not agree are valid. The agency claims that, because of unsuitable climate and soil, quality spinnable cotton cannot be grown economically in Korea. However, information at the Mission shows a long record of Korean cotton production and its utilization in spinning commercial fabrics. The agency further stated that a program initiated in 1960 to expand procurement of Korean-made

commodities for the Korean military forces was suspended because of insufficient counterpart funds due to an economic slowdown in Korea after the revolution in May 1961. The agency acknowledged that the Mission had little influence on Korean budgeting but stated that the situation had been improving.

We are making several recommendations for action by the responsible United States agencies, aimed toward more productive utilization of Korean resources and capabilities, including review of the proposed use of Korean foreign exchange and an effective advisory role in the determination of amounts to be budgeted for civil activities.

Need for tax reform (p. 78)

An inequitable tax system, combined with an unsound collection structure and ineffective administration by the Korean Government, has greatly hampered economic growth in Korea and by reason thereof has contributed to the continued need for substantial outside assistance. ICA recognized the urgency of comprehensive tax reorganization as a means to increase government revenues, overcome widespread tax evasion and other illegal practices, encourage business activity, and attract foreign investment. Technical assistance initiated in 1959 through an ICA-financed contract was terminated by the contractor before completion of the contract work. At the conclusion of our field review, ICA was endeavoring to recruit two tax advisors in response to request of the Korean Government for assistance in the tax field. The Revolutionary Government recently announced a new tax reform plan which would

drastically modify tax revisions recommended by the contractor prior to its withdrawal and enacted into law by the previous Korean Government. The contractor in its final report stated that, until such time as satisfactory tax reform was accomplished, economic growth and development of Korea would be stultified.

We were informed by the agency that one tax administration advisor had been sent to Korea early in 1962 and that the Korean Government had intensified its own efforts in the field of taxation and administration. In view of the paramount importance of effective tax reform in Korea, we are recommending that AID augment its current assistance in order to accelerate the establishment of a sound and effective tax system.

Because of the low tax rate on the sale of motor vehicle gasoline, all of which was financed by ICA, the price of gasoline sold to civilian users in Korea was considerably below gasoline prices in other non-gasoline-producing countries, with the result that considerable revenues were lost to the Korean Government thereby adding to the pressure for higher aid levels. The tax on gasoline was doubled in January 1961; on the basis of consumption in 1959 and 1960 the increased rate, if it had been in effect in these 2 years, would have increased tax revenues by the hwan equivalent of about \$30 million. We understand from the agency that the tax rate was further increased in 1962 by 50 percent.

#### Corruption in Korea (p. 84)

It has been widely recognized by United States authorities that large-scale corruption within the Korean Government,

principally since 1953, has been a major deterrent to economic progress in Korea. According to the Revolutionary Government, corruption and inefficiency were largely responsible for what it considered a condition of economic stagnation in the country but aid provided by the United States and the United Nations was, in general, wisely and efficiently expended. The Mission claimed that it had taken all appropriate measures to identify instances of corruption involving aid funds and to work toward the reduction of corruption. These measures were for the most part those which have been employed as a matter of regular practice in all country aid programs and were not predicated on conditions of widespread corruption such as reportedly prevailed in Korea.

ICA appears to have considered that its responsibility extended to the use of aid funds only and that the effectiveness of measures to combat corruption depended primarily on the sincerity and vigor of the Korean Government.

We are recommending that the responsible United States agencies familiarize themselves with the specifics of corruption, determine the adequacy of Korean Government controls, and maintain active communication on the subject with the highest levels of the Korean Government.

Excessive cost and unwise use  
of investment funds (p. 88)

Extremely high interest rates in Korea on agricultural and industrial loans impeded efforts to channel funds into productive uses and thus retarded development of the economy. The high rates were attributable mainly to the insufficiency of capital in Korea

and the fundamental deficiencies in the traditional banking and monetary structure. These conditions fostered the accumulation of funds outside regular banking institutions and the making of loans to farmers and private business at usurious interest rates. The consequences perpetuated a state of heavy debt, low living standards, and minimal purchasing power in the agricultural community, which comprises more than half the country population, and channeled funds into nonbasic but profitable enterprises rather than essential industrial undertakings, thereby discouraging industrial growth.

It appears that ICA considered its function in the field of loan capital and interest rates as one of advice and encouragement on basic monetary and economic reforms. Mission officials stated to us that their work over the past years laid the foundation for the emergency measures instituted by the Revolutionary Government to relieve the farmers from their oppressive debt burden and to release additional funds for industrial loans in the small and medium industry sector.

The policy of ICA was addressed to broad basic concepts and was not adapted to dealing with immediate problems. This policy suggests the question of whether some or all of the conditions against which the emergency measures of the Revolutionary Government were directed could have been alleviated by ICA and previous Korean Governments if the policy of ICA had been geared to meeting existing demands for short-range benefits as well as formulating and sponsoring fundamental long-range reforms.

The agency advised that banking and financial advisers were recently sent to Korea to review the total fiscal problem and that the progress made by the Revolutionary Government during the latter part of 1961 in attacking usurious creditors, creating a new Industry Bank, and examining ways of making more and lower cost capital available to various sectors of the economy has been in conformity with AID concern for action in this area.

#### COMMODITY IMPORT PROGRAM

Character and control of commodity imports  
were not conducive to economic development (p. 92)

In recent years an increasing proportion of ICA commodity import assistance was devoted to consumable goods despite Korea's need for capital investment. Significant amounts of ICA funds were earmarked for comparatively low priority consumer goods or at the time of our review were not being used while essential activities, such as power development, were delayed or not undertaken.

In 1961 ICA revised its procurement authorization practices by adoption of a "multicode" procurement authorization under which a wide range of commodity classifications are included in a single authorization generally issued for a relatively large amount and without monetary restrictions on individual commodity classifications. As a result ICA had less control over the commodity composition of the import program and hence less means of channeling available resources into those areas which would provide the greatest impetus to economic growth.

We proposed to ICA that (1) it reach agreement with the Korean Government on a system of priorities for the allocation of



both Korean foreign exchange and aid funds designated for commodity imports, to put emphasis on capital goods, and (2) it reconsider its revised procurement authorization practices. The agency expressed general agreement with our proposals and further advised that a comprehensive review was being made of its procurement policies and procedures including the multicode procurement authorization.

Collusive bidding for ICA funds (p. 98)

For a number of years aid funds made available for financing commodity imports were allocated to Korean importers through several systems of auction bidding. In the several years before the exchange rate reform in February 1961, local currency, in amounts not known but acknowledged to be considerable, was lost to the Korean Government through collusive bidding by Korean private industry. The effects of this collusion lessened the resources of Korea for meeting its economic and defense needs and thus slowed down economic progress and increased the pressures for higher dollar aid, enabled the collusive bidders to realize windfall profits, and encouraged loose ethical standards of Korean business practices.

Defects in financing of industrial enterprises as nonproject aid (p. 102)

ICA financed as nonproject assistance under the commodity import program, the establishment and major expansion of industrial enterprises similar in basic characteristics to projects financed under the project assistance program. This type of financing has

had two fundamental defects: (1) the absence of any system of priorities in approving individual enterprises and in allocating aid funds contributed to unbalanced industrial expansion, as reflected by the overexpansion of some industries and the failure of other essential industries to receive needed assistance, and (2) the annual program presentation to the Congress did not show that nonproject funds were used to finance the establishment and expansion of industrial enterprises as single-package activities (projects) basically the same as projects under the project assistance program. In some cases nonproject funds financed the same enterprises that were receiving assistance as projects.

We are recommending priorities in the approval of such enterprises tied into the system of priorities recommended in respect of capital and consumable goods. We are recommending also that, insofar as financing of enterprises from nonproject funds may be continued, the agency develop some practical means of disclosing this type of financing and discontinue the practice of financing the same enterprises from both project and nonproject funds.

Deficiencies in fertilizer program (p. 107)

Fertilizer has been the principal commodity import financed by ICA. Total ICA financing aggregated \$119.5 million for the period 1954-56 and \$235.7 million from 1957 through 1961. The program has been more costly and less beneficial to the Korean agricultural sector than it should have been principally because of the following conditions

1. From 1959 through 1960 the program did not have the benefit of necessary technical guidance by the Mission. The agency claimed that in spite of the absence of a fertilizer technician some effective work in this field had been done. At the time of our field review the Mission fertilizer staff consisted of one American and one Korean. We are recommending that consideration be given to augmenting this staff if the fertilizer program continues at a level approaching that of past years.
2. ICA did not participate in the determination by the Korean Government as to the quantities and types of fertilizer to be imported or as to the use of fertilizer within the agricultural sector and by its own acknowledgment had little knowledge about the needs of the fertilizer program. The Mission had been unable to obtain full access to fertilizer data in the Korean Ministry of Agriculture and Forestry. However in June 1961 the Mission's fertilizer advisor was working full time at the Ministry.
3. Procurement costs were higher than necessary because of (a) failure to purchase in off season and (b) the allocation of increased purchasing of fertilizer to Korean private business which paid a higher price for fertilizer than the Korean Government had paid. In 1961 funds were programed for advance procurement and the new government shortly after May 1961 insisted on 100-percent government procurement.
4. Because of its high price, fertilizer produced by the ICA-financed Chung-ju fertilizer plant was not used for an extended period with resultant loss to the farmers of a substantial quantity of fertilizer for at least one planting season. We were informed that the fertilizer was subsequently sold at a price in line with that of imported fertilizer.

Aid program encouraged new luxury wants  
and uneconomical importing (p. 113.)

Despite Korea's extreme trade imbalance and the low standard of living of most of the Korean people, United States aid funds financed imports of luxury or semiluxury materials such as top-quality wool and nylon yarns which were used to produce wearing apparel. Before the aid program the Korean population dressed in clothing made predominantly from cotton and silk, both of which

were produced locally. Thus consumption habits beyond the standard possible to be maintained at present by the country's economic resources were encouraged; aid funds were not utilized to the best advantage of the Korean economy; and local industries, particularly cotton, were adversely affected. ICA technical advisory personnel reported that it was unwise to continue financing wool and nylon yarns because of their very high quality, relatively high cost, and luxurious nature. The agency attributed the use of aid funds for such purposes to the pressure of Western influences and the demands of an industrializing economy.

The aid program also financed the import of pulp without taking advantage of economies that could be realized through the use of wastepaper in mix with chemical pulp in the manufacture of certain kinds of paper. The agency informed us that it has continued to sponsor the use of wastepaper in paper manufacturing but apparently the industry does not yet fully understand or has not become convinced of its advantages.

We are recommending the adoption of more austere and realistic standards in allocating resources to assure their utilization for purposes of more essential and lasting benefit to the Korean economy.

Korean Government restrictions created shortages of gasoline and automotive parts which contributed to pilferage of military supplies (p. 117)

The Korean Government was unwilling to import all the gasoline that ICA estimated was needed for civilian use and consistently refused to permit the civilian economy to secure and use

automotive spare parts excess to military requirements. The shortages of these items for civilian use were responsible in a significant measure for the large-scale illegal diversion of stocks of these commodities provided for the Korean and United States military forces stationed in Korea.

The Korean Government accepted a higher funding level for gasoline for calendar year 1961. We are recommending that ICA reconsider its withdrawal of support for a proposal by the United States Army to the Korean Government to permit the sale of those automotive parts that are excess to requirements of the military forces in Korea and that are not manufactured in Korea.

## PROJECT ASSISTANCE

### Continuing power shortage (p. 120)

Electric power is a major requisite to economic development in Korea. Its progressively increasing shortage, in spite of \$70 million in aid and substantial counterpart funds for projects, has been a major deterrent to economic development. Financial instability of the power companies, caused mainly by an inadequate rate structure; extended delays in implementing aid-financed power projects; and failure to agree upon a dependable long-range power plan have deprived the power system of significantly greater capability to supply Korea's requirements. As a consequence the present industrial plant of Korea has been unable to realize its productive capacity and further industrial expansion has been inhibited.

In spite of known power limitations, ICA financed a program of industrial expansion without fully assessing the expected availability of adequate power to operate these industries. As a result, electric power has been rationed to residential and commercial customers in Korea and industrial facilities, including those financed by ICA funds, have been unable to operate fully because of a lack of power.

Mission officials reported that the power shortage is likely to increase until 1964. It was our understanding at the time we completed our field work that decisions had not been reached as to the types and locations of additional plants to meet the need for electric power.

We are recommending particularly vigorous effort on the part of the responsible United States agencies aimed toward formulation of a systematic power development plan, more expeditious contracting procedures to minimize delays in project implementation, and timely determination of the financial adequacy of power operating results following recent rate increases and organizational changes. Unsatisfactory results of industry program (p. 128)

Industrial facilities financed by ICA under the small and medium industry programs were not, for the most part, being successfully operated as business enterprises. At June 30, 1961, only 14 percent of these enterprises were operating at as much as 75 percent of capacity and were current in their loan repayments. Projects in the once thriving silk industry were so poorly administered that silk production actually decreased, silk filature mills were partially unused, and this industry had not made its expected increment to farmers' income or foreign exchange earnings.

The poor showing of the industry projects was due primarily to (1) inadequate planning with respect to available raw materials and prospective markets, (2) delays in project implementation caused by slow processing of hwan loans and changes in project plans, (3) financing difficulties, such as project sponsor irregularities, excessive size of project loans in comparison with sponsor equity, and the freezing of sponsor deposits for lengthy periods, and (4) shortage of power supply. Project audits by ICA were tardy and infrequent. The agency pointed to the several changes in the Korean Government and in Korean exchange rates as having

hampered the progress of the industry program and stated that in spite of these conditions the operations of the industry projects added significantly to the gross national product and to employment in Korea in 1961.

We urged ICA to take such steps as would resolve the problems of each of these projects in the most expeditious and beneficial manner practicable in the circumstances. The agency advised us that many steps had been taken including review on a case-by-case basis with a view to refund requests or cancellation where appropriate.

Major housing projects had not achieved their intended goals (p. 134)

Of the three projects which composed the long-range housing program, the major one, involving the construction of housing, had fallen far behind the timetable fixed for completed units; another, for promoting building-material plants, was to be terminated for lack of qualified sponsors; and the third one, for housing research and development, had not undertaken its primary function. An emergency subproject for reconstruction of housing because of typhoon damage had benefited relatively few families 2 years after the typhoon. An important factor in the delay of the construction project was the procurement of lumber that was unsatisfactory for the purpose intended.

The Mission had recognized that these projects had not been successful and advised us that, pending Mission review of its housing program and of the intentions and plans of the new Korean Government, the composition and extent of the future housing program were indefinite.



The agency reported that no further dollar financing is contemplated and that continuing activities will be financed with counterpart funds. Regarding the subproject concerned with typhoon damage, the agency advised that all families subsequently received the assistance as planned.

Project for construction of new health facilities was poorly planned and administered (p. 139)

Although estimated for completion by mid-1957, very few of the hospitals, health centers, and other facilities included in this project were operating satisfactorily at June 30, 1961. Some of the structures were not finished, others were either improperly constructed or lacked adequate utilities for successful operation. Much of the equipment for these facilities was still at the port of entry or was unused at the building site.

From our examination it seems clear that this project received little if any considered planning, that technical supervision and management control were very limited, and that the funds were obligated considerably before the project was ready to use them. The record indicates that at the time the initial funds were obligated neither engineering plans nor cost estimates had been developed in anything more than skeleton form.

The agency advised in July 1962 that construction of all facilities had been completed and that at least basic staff and budget had been provided by the Korean Central and Provincial governments.

Problems in higher education program (p. 140)

The curriculum at the College of Engineering at Seoul National University (SNU) was developed without direct knowledge of the types of engineers and scientists needed in Korea. As a consequence Korean economic development probably did not receive the full potential benefits of this branch of higher education; moreover assistance was given to courses which appeared to make a relatively small contribution toward existing and foreseeable Korean economic requirements. In addition much of the equipment furnished under the program had not been installed and other equipment had not been utilized because of the lack of power and heat.

We pointed out to ICA the importance of taking positive steps to encourage balanced college education in line with the proximate needs and opportunities in the country--with particular stress on follow-through with the Korean Government of a joint ICA-Korean recommendation for a survey to determine the requirements for engineers and scientists--and to remedy the above conditions regarding equipment installation and utilities. The termination at June 30, 1961, of the major portion of the contract with a United States university for advisory services and training points up the responsibility of the agency to provide such qualified personnel as may be necessary to carry out the above tasks.

The agency informed us in March 1962 that the education program had been substantially revised, coinciding with a revamping of the Korean educational system by the present Korean Government, which includes emphasis on vocational training and reduction of

college enrollments from 145,000 to 50,000 of which two thirds are to be channeled to technical and vocational junior colleges. The agency further advised us that the power situation had been improved and that, as of January 1962, two thirds of the equipment had been installed and local currency had been budgeted to complete installation.

Unsuccessful expansion of  
government-controlled shipyard (p. 144)

The Dae Han Shipbuilding Corporation (Pusan Iron Works) which received ICA-financed equipment and machine tools amounting to about \$2 million was operating on a very limited scale, and much of the ICA-furnished equipment was idle. Although ICA and the Korean Government had recognized for several years the need for reorganizing and refinancing this corporation, such had not been done at the time of our review.

The Dae Han Shipbuilding Corporation (DHSC) is a former Japanese enterprise now operated by the Korean Government which owns more than 97 percent of the corporation's stock. ICA committed \$2 million in June 1955 to purchase equipment in connection with the expansion of the shipyard, including a modern foundry and a machine shop.

The project had little, if any, planning as to basic requisites such as (1) the needs of the country for the various types of operations which were established or expanded, (2) the channeling of required needs of other government units to the corporation rather than outside the country, (3) the coordination of operational capacity with the limited power availability, (4) the

competency of local management, and (5) the financial status and requirements of the corporation.

As a consequence the facility had been largely idle while at the same time Korean ships were being repaired abroad, duplicate machine tool facilities were being established by the Korean military forces, and products that could be manufactured by DHSC were being imported. Some equipment could not be used because of a shortage of electric power. DHSC encountered financial difficulties and was unable to pay the duty on the ICA-financed equipment. At the time of our visit the equipment was located in the shipyard plant and we were informed by the agency that the Korean Government had deferred and subsequently waived payment of the duty on the equipment.

We are recommending that the responsible United States agencies urge upon the Korean Government certain actions to reorganize DHSC, to have Korean agencies procure maximum requirements from DHSC, and to determine those items that DHSC can supply to the Korean military services which are now imported under the military assistance program. In a separate report to be issued to the Congress on the local currency military budget support program, we plan to recommend reappraisal of the basis for providing and supporting machine tool facilities within the Korean military forces which duplicate facilities at DHSC.

Limited success of vocational education program (p. 150)

Despite Korea's urgent need for skilled workers and technicians, the vocational education program had little success in

developing trade skills. Because of poor planning, implementation, and country cooperation, much of the equipment provided by ICA for more than 50 schools had not been used effectively. In recognition of this unsatisfactory progress, ICA decided in 1960 to concentrate on one technical school in Seoul which would serve as a national demonstration center.

The agency reported in March 1962 that all equipment furnished the Korean technical high schools had been installed and that the Korean Ministry of Education with the assistance of the Mission was working on a program under which shop students would spend more hours per week in shop practice utilizing ICA-financed equipment.

#### LOCAL CURRENCY

##### Inadequate control over deposit of counterpart funds (p. 152)

Although the total amounts deposited into the counterpart deposit account were consistently and substantially less than the total amounts required to be deposited, the records and procedures of the Mission were not organized to enable ready determination of the difference or what it represented. Thus the Mission was not in a position to know whether the local currency side of the commodity import program was being satisfactorily administered, particularly in such important aspects as timely and full deposits and the expeditious movement of aid-financed commodities into the Korean economy based on deposits made or due on individual commodity shipments.

This situation had existed since the early years of the program and was pointed out in our previous report issued in 1957. In that report we stated that reliance as to deposits was placed principally on Korean reports which were unreliable and were not being reconciled with the records of the Mission. Our current examination found the situation substantially unchanged.

Tentative results of a reconciliation of required and actual deposits for the period from fiscal year 1954 through December 31, 1960, which was in process at the Mission in June 1961, indicated a difference of 46.8 billion hwan, equivalent to \$36 million at the current exchange rate of 1,300 hwan to \$1.

We suggested to the agency that the Mission complete the reconciliation and proceed to settle the differences and to put into effect the revised procedures which were developed for accounting, reporting, and controlling counterpart deposits.

The agency advised in March 1962 that (1) counterpart billings, deposits, and withdrawals through August 31, 1961, had been reconciled and (2) current negotiations were being held with the Korean Government to simplify and revise accounting procedures. AID stated that it was weighing the cost to the Korean economy of requiring collection and deposit of counterpart arrears against the cost to the aid program of agreeing to write off these arrears as an acknowledged subsidy not originally anticipated in the United States aid program.

Faulty administration and control  
of counterpart loan program (p. 154)

Our review of the counterpart loan program administered by the Korean Reconstruction Bank (KRB) indicated several areas of deficient operation by KRB and a want of necessary over-all monitoring by the Mission. Many loans were delinquent as to principal and interest, and some loans appeared to have been of questionable financial risk. We noted several instances in which principal and interest payments were not deposited promptly into the counterpart account; service charges were being taken on loans in arrears, contrary to CEB authorization; and penalty interest collected was being improperly retained by KRB for its own account. The Mission had not made and did not have plans for any audits of the eight revolving funds administered by the three government-controlled banks (KRB, Bank of Korea, and Korean Agricultural Bank). Except to the extent required in audits of ICA-financed projects, the Mission had not made any audits of other loans under the counterpart loan program and had not examined the banks' lending practices. The fund and status reports received by the Mission from KRB did not show delinquent loans or the amounts of principal or interest in arrears and thus were not sufficiently informative to provide a basis for Mission control.

In response to our proposal for certain specific actions designed to correct the above conditions, the agency advised (1) that the Mission planned to review the several counterpart loan programs and the status of repayments in early 1962, (2) that the

organization and function of the KRB were then under review by the Korean Government and the Mission, and (3) that a similar review was planned for the loan programs of the other banks, but not, at that time, for the revolving funds because of staffing limitations and lower priority of the revolving funds in relation to dollar and other local currency aid activities.



## STATUS OF PRIOR FINDINGS

As part of our examination we checked on the major findings which were the subjects of our previous report to the Congress, issued in June 1957. These findings are identified below and are followed by a synopsis of their status at the time we checked on them in the spring of 1961. Certain matters previously reported which are also covered in this report as part of our current examination are cross-referenced to the appropriate sections of this report.

### MALPRACTICES IN THE COMMODITY IMPORT PROGRAM

#### As previously reported

The commodity import program was burdened by various undesirable practices in connection with procurement by the Korean Government as well as procurement in the private commercial sector administered through the Bank of Korea.

(1) The agencies of the Korean Government ignored specifications recommended by Mission advisors and did not follow the ICA policy favoring world-wide procurement at lowest prices, especially because of reluctance to buy from Japan.

(2) Laxity by the Bank of Korea in the allocation of aid dollars to importers had encouraged speculation and led to a number of procurement irregularities, such as collusion between supplier and importer, shipment of defective merchandise, kickbacks, and overpricing.

(3) Considerable quantities of goods accumulated in warehouses for unreasonable lengths of time. This had been, among

other reasons, due to shortage of rail facilities, lack of funds in the hands of importers, and unclaimed aid goods.

(4) End-use investigations by the Mission were insufficient in coverage of principal procurement areas and in follow-up of unsatisfactory situations disclosed.

As currently checked

(1) We have been informed by the Mission that the Korean Government procurement agency is now fully cooperative as to bid specifications and attempts to procure at the lowest landed cost regardless of source country. We noted, however, one exception involving the procurement of cotton for the Korean Army; an estimated premium price of \$100,000 was paid because of unusually short delivery provisions and rejection of the Mission's advice that the invitation to bid be corrected to conform to standards of the cotton trade.

(2) According to the Mission, the Bank of Korea now requires prospective importers to register with the Ministry of Commerce and Industry or one of the other ministries, and the irregularities between supplier and importer have been minimized by the function of a pricing section in the Foreign Fund Operations Department of the Bank of Korea. However, we observed several ICA-financed procurements in which bids or offers were identical for all suppliers. Prices appeared to have been established by export trade associations or their agents rather than by free competition. The procurements involved fertilizer and cement, commodities of considerable dollar value. We also noted that importers often

submitted only one offer to the Bank, and, in these cases, it would appear that there was little assurance of adequate solicitation of suppliers or that the offer submitted was the best offer received by the importer. Our current findings with respect to collusive bidding for ICA funds are discussed at page 98.

(3) Goods valued at \$6 million stored in the Korean Office of Supply (OSROK) and customs warehouses at February 28, 1961, had been there for at least 6 months. The agency informed us that the value of goods similarly in storage at November 30, 1961, totaled \$5.2 million and that an additional \$3.5 million worth of goods, most of which was for the Dae Han Shipbuilding Corporation (see p. 144), had been released to end-users without payment of duty. Some of the reasons given as to why these items had not been withdrawn from storage were (1) shortage of funds by the end-user to pay various charges, (2) project commodities not yet usable because of delays in the project and in finding new sponsors, and (3) unmarketable goods or those not in demand, such as the more unpopular types of fertilizer. Efforts by the Korean Government to sell certain items at auction were not successful because the floor price was higher than potential purchasers were willing to pay. According to Mission personnel, this floor price, established by the Customs Office in Pusan, covered the commodity value, customs duties, customs tax, miscellaneous fees, and a "benefit" or profit allowance to the importer. Revised procedures calling for reductions in the floor price at successive auctions have been adopted. In addition the Mission and the Korean Government have

black-listed from additional ICA-financed transactions those importers who have not withdrawn their cargo from customs. Studies by the Mission disclosed that this practice was not completely effective because of multiple registrations involving related companies. In August 1960, the Mission engaged an outside company to devise a system to prevent further accumulation of cargo and to train personnel to operate the system. The agency reported that this work, completed in 1961 after our field examination, resulted in the adoption by the Korean Government of (1) procedures which will progressively reduce floor prices to an eventual "knock-down price" type of auction and (2) a new law subjecting to auction goods in warehouses for 2 months and goods not removed within 10 days after duties and charges have been paid.

(4) The over-all end-use audit function appeared to have been strengthened in staffing and audit coverage except for audits of projects and counterpart loans which have lagged in number and timeliness. The agency has advised that the Mission Audit Branch has been reorganized along functional lines and that increased audit attention will be given to project activities financed with dollars and local currency.

#### DEFICIENCIES IN FERTILIZER IMPORT PROGRAM

##### As previously reported

Because of unsound distribution procedures, farmers had not received fertilizer at the agreed prices and at the time when needed. Extensive black-market operations were reported. The sale of the fertilizer within Korea had not produced the expected

cash proceeds. The Mission had not received adequate accounting on proceeds realized or an explanation of certain other transactions affecting the disposition of fertilizer.

As currently checked

The fertilizer program was covered in our current examination, and our findings thereon are discussed at page 107 of this report.

## WEAKNESSES IN ADMINISTRATION OF COUNTERPART FUNDS

### As previously reported

(1) There was no careful programing of availabilities and requirements prior to the approval of releases by the Combined Economic Board.

(2) The Mission had not independently determined or otherwise accounted for sales proceeds to be deposited to the aid goods collection account. The agency relied principally on Korean reports, but these had not been found reliable in all instances and necessary reconciliations with the agency's own records had not been made.

(3) The Mission had no systematic accounting for counterpart funds by individual project and lacked meaningful reports.

(4) The Controller's Office of the Mission had made no up-to-date audit as to progress of principal projects financed with counterpart funds.

(5) There was no agreement with the Korean Government on the disposition of repayments of loans from the counterpart account.

### As currently checked

(1) The Mission established a Counterpart Programing Division responsible for these functions, and programing of availabilities and requirements appeared to have been generally improved.

(2) The Mission had not established adequate controls in this area. This subject is discussed at page 152 of this report.

(3) Accounting records were being maintained by project and periodically consolidated into status reports.

(4) The Mission was still somewhat deficient in this area as further discussed at page 132 of this report.

(5) An agreement had been reached to deposit all receipts in a special account to be used subsequently for industrial development.

THERMAL POWER PLANTS CONSTRUCTED  
UNDER NONCOMPETITIVE CPFF CONTRACT

As previously reported

There had been no solicitation of bids for a 30-million-dollar cost-plus-fixed-fee contract for the construction of three thermal power plants. The contract was negotiated and financed by ICA at special request of the Korean Government.

As currently checked

The three plants were completed ahead of schedule; over-all operating supervision and on-the-job training were finished in mid-1957. The total cost of the project was \$28 million. According to Mission personnel, there was a need for more technical training in maintenance and supply management, some employees trained under ICA participant training projects were assigned to work other than that for which they had been trained, funds had not been made available in a timely manner resulting in failure to maintain adequate stock levels, and there was a continuing problem of excess employees in the plants.

COST INCREASES IN THE REHABILITATION  
OF KOREA'S MAJOR HYDROELECTRIC PLANT

As previously reported

The rehabilitation of the Hwachon Dam was scheduled for completion before the close of calendar year 1957. The project had required increases in ICA funding from 5.3 million dollars to close to 9 million dollars. After 2 years of survey work and engineering and construction services at the site, it had not been possible to determine the exact nature and extent of repair work needed because of lack of a sufficiently specific survey and the amount of war damage suffered which had been extensive and was difficult to discover.

As currently checked

The rehabilitation was completed in February 1958 at a cost of \$9.5 million. Mission reports indicated that the plant was operating in a satisfactory manner.

PROGRESS IN TELECOMMUNICATIONS PROJECTS  
AFTER INITIAL DELAYS AND REPROGRAMING

As previously reported

We noted progress in the installation of additions to the central telephone exchange in Seoul, under supervision of an American contractor; rehabilitation of the outside cable plant and the work in the provinces were undertaken by the Korean Government. There had been some unrealistic planning and financing in prior years, causing delays in the execution of the projects and requiring substantial reprogramming.



As currently checked

The Seoul exchange and cable projects were completed in 1959, and the outside plant was expected to be finished in October 1961. Other old telecommunications projects were expected to be completed by early fall of 1961. Mission personnel reported that, in general, the program had been very successful in the last 4 years, as indicated by the increase in main-line subscribers from 25,000 at the beginning of 1955 to 87,000 at the end of 1960.

IMPROVEMENT OF WATERWORKS IN SEOUL,  
BUT SLOW PROGRESS IN THE PROVINCES

As previously reported

A continuing program of rehabilitating and expanding city water supply systems throughout Korea had added significantly to the water supply in Seoul, but progress had been considerably slower in other cities.

As currently checked

All of these waterworks projects had been completed by 1958, and water supply in 56 cities had been increased from 248,000 to 450,000 cubic meters daily for 6.5 million people.

PLANNING DEFICIENCIES AND PREMATURE COMMITMENT  
OF AID FUNDS FOR CONSTRUCTION OF FERTILIZER PLANTS

As previously reported

ICA had committed \$40.5 million for construction of two fertilizer plants, supplemented by local currency financing of \$7 million equivalent from counterpart funds.

Fertilizer plant No. 1 was being erected on a site which technicians in Korea considered undesirable. Changes in engineering

design and slow negotiations with the contractor had delayed construction and increased costs. A new process which the plant was to use had caused concern to some officials.

Plant No. 2 had been approved by ICA before the kind of fertilizer to be produced, the type of raw material to be used, and the plant location had been determined. Plans for plant No. 2 were subsequently abandoned, and the aid funds were reprogramed.

A report issued by us in April 1960 to the Congress on our review of contracts dated May 13, 1955, and March 27, 1959, with McGraw-Hydrocarbon, a Joint Venture for the Construction and Operation of a Fertilizer Plant in Korea (B-133290), brought out that construction costs had increased substantially, the penalty clause for delayed completion of the plant was not effective, the services and training contract was awarded to McGraw-Hydrocarbon without evidence of satisfactory performance under the construction contract, and authorized compensation for services and training appeared high.

As currently reviewed

The plant began producing urea in February 1960, but mechanical difficulties delayed production at the capacity guaranteed by the contractor until early in calendar year 1961. At December 31, 1960, obligations of ICA and counterpart funds for the project were as follows:

|  | <u>ICA funds</u><br>(millions of dollars) | <u>Counterpart</u><br>(millions of hwan) |
|--|---|--|
| Plant construction                         | \$35.3                                    | 2,750.3                                  |
| Training and advisory<br>contract services | 5.5                                       | 5,490.3                                  |
| Housing                                    | <u>.2</u>                                 | <u>502.0</u>                             |
| Total                                      | <u>\$41.0</u>                             | <u>8,742.6</u>                           |

At the close of the quarter ended March 31, 1961, the plant was operating at 64 percent of rated capacity. On the basis of operating and financing costs, the cost of fertilizer was higher than imported fertilizer. In order for the plant to be competitive, adjustments in interest rates on loans and in charges for depreciation and write-off of start-up or preproduction costs will be necessary. Although the contract with McGraw-Hydrocarbon for plant operation, maintenance, and training was to terminate in December 1961, the Korean Government had made no attempt to extend or replace the contract. In the opinion of Mission personnel, Korean employees by themselves neither had nor will have in the near future the technical ability to properly operate and maintain the plant, particularly since about 40 key Korean employees were being inducted into the Army at the time of our review. Many of them had been trained by ICA.

The agency informed us in March 1962 that production during the late months of 1961 was considerably better and in December reached 103.6 percent of rated capacity, that with Mission persuasion the Korean Government had indicated plans for discontinuing subsidies on Government-imported fertilizer, and that the services

and training contract with McGraw-Hydrocarbon had been terminated in favor of a new contract to be executed with another firm.

The lag in sales of fertilizer due to its noncompetitive price and the effect thereof are discussed at page 111 of this report.

## SLOW PROGRESS IN SMALL INDUSTRY PROGRAM

### As previously reported

The program for rehabilitation and expansion of small industries had not received the necessary technical review and advance planning. Many of the projects showed unsatisfactory progress in terms of lagging procurement, unrealistic arrangements for financing local costs, and unsolved technical problems. Equipment for some plants had arrived but was held in customs pending technical and financial assistance needed for its installation.

### As currently checked

This program was reviewed as part of our current examination and is discussed at page 128 of this report. We believe that the program has not been successful; the agency does not agree.

## DELAYS IN THE REHABILITATION AND TECHNICAL EXCHANGE PROGRAM FOR SEOUL NATIONAL UNIVERSITY

### As previously reported

Starting in 1954, the Mission had sponsored a program of rehabilitation for Seoul National University and had engaged the services of a United States university for technical advisory services, training, and the procurement of laboratory equipment. However, materials for the rehabilitation of the physical plant and equipment for laboratory facilities did not begin to arrive until September 1956 and the technical services in Korea as contemplated under the contract had not been furnished.

As currently checked

This program encountered various problems which prevented it from achieving its full aims. These problems are discussed at page 140 of this report.

DELAY IN PROCURING MANAGEMENT ENGINEERING  
AND OTHER TECHNICAL SERVICES

As previously reported

ICA had not procured needed technical services. Obligations recorded in 1954 and 1955 in excess of 3 million dollars for management and engineering services and surveys remained unused at September 30, 1956. In January 1957, the agency fulfilled previous plans for an over-all management engineering contract and procured the services of a group of firms specializing in various fields essential to the development of South Korea.

As currently checked

The over-all management contract was terminated in February 1961; the services formerly rendered by the contractor were to be carried out by the Mission staff. A Mission report in July 1960 indicated that some divisions of the Mission were not satisfied with the services of the contractor.

LAG IN HOUSING PROJECTS

As previously reported

Up to 1956 ICA financing in housing was limited to the provision of office space for the Korean Government and quarters for the agency's overseas personnel. Under a 1954 architectural contract, costing \$142,000, ICA financed plans for a combined Mission-Korean Government office and hotel building. However, American

and Korean representatives did not reach agreement on the acceptability of the proposed project and decided to abandon it. In June 1955, ICA obligated 1.5 million dollars for construction of an office building, for use by the Korean Government. Further disagreements developed concerning the execution of this second proposal, and a construction contract had not been awarded at the time of our examination in 1956.

As currently checked

An additional \$85,000 was spent for architect/engineering services, and construction contracts were finally let in 1960 for two office buildings--one early in the year for the Korean Government building and the other several months later for a building to be occupied by the Mission. Construction was on schedule, with occupancy expected by August 1961. The contract for the Korean Government building was awarded on the basis of the lowest of three bids received; the contract for the Mission building was awarded to the same contractor by direct negotiation without solicitation of any other offers. Both contracts were for lump sums aggregating \$3.5 million for dollar costs, local costs were on a reimbursable basis. Profits and fees on both contracts were estimated at \$370,000. A Mission report on audit of the two contracts for the period from inception of the contracts to January 18, 1962, stated that (1) certain work remained to be done for which the contractor requested extension to June 30, 1962, and (2) profit on the two contracts based on the contractor's records in Korea approximated \$638,000 subject to possible upward adjustment for certain

questioned transactions. The records of the agency indicate that the contractor, although not required by the terms of the contracts, has agreed to renegotiate and adjust for any excess profits disclosed by final audit.

UNSATISFACTORY PROCEDURES FOR THE PURCHASE AND CONTROL  
OF ADMINISTRATIVE SUPPLIES AND EQUIPMENT

As previously reported

There was a need for more discriminate buying of administrative supplies and equipment, for a tightening of the requisitioning system, and for proper documentation of price quotations. At the time of our examination, the Mission had not established a system of property accountability for nonexpendable office equipment and residential furnishings. The agency maintained no inventory and use records for consumable supplies. In September 1956 improved requisitioning and purchasing procedures were drafted, as well as a system for property accountability.

As currently checked

Procedures with respect to the above operations had been instituted, and from our observations they appeared to be functioning satisfactorily.



**REPORT TO  
THE CONGRESS OF THE UNITED STATES**

**EXAMINATION OF  
ECONOMIC AND TECHNICAL ASSISTANCE PROGRAM  
FOR KOREA  
INTERNATIONAL COOPERATION ADMINISTRATION  
(SUCCEEDED BY AGENCY FOR INTERNATIONAL DEVELOPMENT)  
DEPARTMENT OF STATE  
FISCAL YEARS 1957-1961**

**PART II**



**BY  
THE COMPTROLLER GENERAL OF THE UNITED STATES  
SEPTEMBER 1962**

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## DESCRIPTION OF AID PROGRAM

### NATURE AND OBJECTIVES

The United States provided substantial economic assistance to Korea under a variety of programs from the end of the Japanese occupation in 1945 to the start of the current program in 1954, as shown by the following summary:

1. \$378 million for relief and rehabilitation during the period of the American military government between 1945 and 1948.
2. \$200 million for economic aid administered by the Economic Cooperation Administration between 1948 and 1951.
3. \$333 million administered by the Korean Civilian Assistance Command of the United States Army during the Korean conflict.
4. \$93 million as the United States portion of the program of the United Nations Korean Reconstruction Agency.

These programs and the manner in which they were administered were described in our prior report.

The current economic assistance program began in fiscal year 1954, after termination of the Korean hostilities, under the administration of the Foreign Operations Administration (FOA), predecessor agency of ICA and continued under ICA and its successor, the Agency for International Development (AID).<sup>1</sup>

The basic objectives of the ICA program in the 1954-56 period (covered by our prior report) were to reconstruct war damage and to assist in maintaining Korean military forces. Assistance was given to finance reconstruction and improvement projects, with major emphasis on essential utilities and transportation services. Substantial amounts were also made available for the rehabilitation of existing industries and for establishing a new industrial base. In addition, through the commodity import program, essential commodities such as food, fertilizer, and raw materials needed to maintain consumption levels were imported, and the local currency proceeds were used to support the Korean military budget

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<sup>1</sup>Since AID did not succeed ICA until after the conclusion of our field audit, we refer to ICA as the administering agency in this report.

and for local costs of rehabilitation projects. During 1957, the rehabilitation effort was largely completed and pre-Korean-war living standards were restored or exceeded.

The stated objectives of the program in the 1957-61 period, covered by this report, were to help maintain essential consumption by importing food, fertilizer, and essential raw materials and, through the use of the local currency proceeds derived from these imports, to help maintain Korean military forces through support of the Korean military budget. In addition, the ICA program was designed to strengthen the basic structure of the Korean economy so that the country could provide a larger share of its requirements from domestic production.

Direct United States economic assistance to Korea since the end of the Korean war is summarized below:

| <u>Obligations at June 30, 1961</u>         |                     |                |                         |
|---|---------------------|----------------|-------------------------|
|   | <u>Fiscal years</u> |                |                         |
|   | <u>Total</u>        | <u>1954-56</u> | <u>1957-61</u>          |
|   | (millions)          |                |                         |
| ICA and predecessor agency:                 |                     |                |                         |
| Commodity imports                           | \$1,342.7           | \$425.1        | \$ 917.6                |
| Project assistance                          | 504.6               | 290.7          | 213.9                   |
| Cash grant                                  | 20.0                | -              | 20.0                    |
| Overseas administration                     | 9.5                 | 2.1            | 7.4                     |
| Emergency relief and assistance             | 9 0                 | 9.0            | -                       |
| Ocean freight on voluntary agency shipments | <u>4.8</u>          | <u>2.7</u>     | <u>2.1</u>              |
| Total                                       | <u>\$1,890.6</u>    | <u>\$729.6</u> | <u>\$1,161.0</u>        |
| Development Loan Fund:                      |                     |                |                         |
| Development loans                           | <u>\$ 22.0</u>      | <u>\$ -</u>    | <u>\$ 22 0</u>          |
| Public Law 480:                             |                     |                |                         |
| Title I                                     | \$ 214.6            | \$ 61.7        | \$ 152.9                |
| Title II                                    | 28.4                | -              | 28.4                    |
| Title III                                   | <u>104.5</u>        | <u>28.7</u>    | <u>75.8<sup>a</sup></u> |
| Total                                       | <u>\$ 347.5</u>     | <u>\$ 90.4</u> | <u>\$ 257.1</u>         |
| Department of Defense:                      |                     |                |                         |
| Armed forces assistance to Korea            | <u>\$ 27.9</u>      | <u>\$ 22.0</u> | <u>\$ 5.9</u>           |

<sup>a</sup>1961 data not included.

## COMMODITY IMPORT PROGRAM

The commodity import program has been designed to (1) finance investment and consumption commodities which Korea needed but could not produce locally and did not have the foreign exchange to purchase and (2) generate Korean currency (hwan) to support the Korean military budget and finance the local costs of economic development projects and related activities.

The commodity program has been composed of (1) consumption goods, such as foodstuffs, fuel, medicines, and raw materials needed to produce consumption goods--principally cotton and fertilizer--and (2) investment goods, such as industrial machinery and goods needed to produce investment goods--for example, lumber. The types of commodities financed under this program are shown in schedule 3, page 163.

ICA program guidelines suggested that the program should be so constituted as to (1) stimulate domestic production where possible by reducing imports purchased with aid funds as rapidly as domestic production could be developed and (2) provide maximum incentive for Korean exporting.

The method by which the Bank of Korea allocates ICA funds to applicants has changed a number of times since the start of the ICA program. Summarized briefly are the bases that have been used.

| <u>Date</u>                    | <u>Basis for dollar allocations</u>  |
|--------------------------------|--|
| Prior to August 1955           | Awarded to highest bidder on basis of amount of hwan bid for each dollar of allocation.  |
| August 1955 -<br>August 1958   | Awarded on official rate of exchange (500 hwan per dollar) plus rate bid for national bonds. Highest amount of hwan bid for national bonds determined the priority of allocations.   |
| August 1958 -<br>February 1961 | Awarded on the basis of official rate of exchange (500 to 1 until January 1960, 650 to 1 until January 1961, 1,000 to 1 until February 1961) plus an additional amount of foreign exchange tax. The amount of tax bid determined priority of allocation. |
| February 1961 -<br>April 1961  | Awarded on basis of official rate of exchange (1,300 to 1). Priority of allocation determined by amount of initial deposit.  |
| Since April 1961               | No competitive award    Availability of funds announced in newspapers    Funds allocated to all applicants at official rate of 1,300 to 1.   |

## PROJECT ASSISTANCE

Project assistance was directed to specific undertakings developed jointly by ICA and the Korean Government and covered by individual project agreements setting forth the specifics of the undertaking and the commitments of the United States and Korean Governments. Project assistance generally consisted of (1) financing the import of equipment and materials, (2) furnishing technical assistance, and (3) providing training to selected Korean nationals. For the fiscal years 1957 through 1961, project assistance declined progressively from a high of \$96.5 million in 1957 to \$11.6 million in 1961. At the time of our review ICA was concerned more with reevaluating and administering existing projects than with initiating new projects.

Following is a summary of project assistance, by major field of activity, for fiscal years 1954 through 1961.

| <u>Activity</u>                             | <u>Obligations<br/>at 6-30-61</u><br><br>(millions) |
|---|---|
| Agriculture                                 | \$ 27.6   |
| Industry and mining                         | 175.0   |
| Transportation                              | 183.5   |
| Health and sanitation                       | 17.2  |
| Education                                   | 18.2  |
| Public administration                       | 5.4   |
| Community development                       | 17.9  |
| Other                                       | <u>28.1</u>   |
| <br>Total commodities and contract services | <br>472.9   |
| <br>United States technicians               | <br>17.5  |
| Technical support                           | 8.6   |
| Participant training                        | <u>5.6</u>  |
| <br>Total project assistance                | <br><u>\$504.6</u>                                  |

The major projects in each of the above fields are shown in schedule 4, pages 164 to 167.

## CASH GRANT

In connection with the revision of the exchange rate of the Korean hwan from 650 to 1,300 hwan to the United States dollar, the United States made a grant of \$20 million in cash to the Korean Government. The grant was considered necessary to compensate Korea for expected short-term reductions in foreign exchange



earnings resulting from the hwan devaluation and to sustain confidence in the hwan. The contemplated reduction was expected to stem principally from reduced sales of hwan, goods, and services to the United States/United Nations (US/UN) forces in Korea, which sales constituted one of the main sources of Korean foreign exchange earnings.

## LOCAL CURRENCY

Local currency was made available to support the Korean military budget and for the local costs of technical cooperation and economic development projects within Korea, approved by ICA. These funds derived from:

1. Commodity imports financed by ICA under the mutual security program.
2. Proceeds from the sales of surplus agricultural commodities under section 402 of the Mutual Security Act of 1954.
3. Proceeds from the sales of surplus agricultural commodities under title I of Public Law 480.

Counterpart funds are maintained in a Korean Government account in the government-controlled Bank of Korea. The proceeds from sales of surplus agricultural commodities are deposited into United States Treasury accounts. The funds from all these sources may be used only for purposes agreed upon by the Korean and United States Governments.

Total collections of local currencies from fiscal year 1954 through December 31, 1960, and the purposes for which they were allocated in that period are summarized below.

|   | <u>Counterpart</u> | <u>Section 402</u> | <u>Public Law 480</u> |
|---|--------------------|--------------------|-----------------------|
|   | (billions of hwan) |                    |                       |
| Collections   | <u>560 0</u>       | <u>118 5</u>       | <u>81 0</u>           |
| Allocated for   |                    |                    |                       |
| Budget support for Korean national defense              | 72 6               | 116 9              | 62 1                  |
| Local costs of project assistance                       | 294 7              |                    |                       |
| Loans through Korean Government banks                   | 112 6              |                    |                       |
| Handling charges and relief costs                       | 18 6               |                    |                       |
| Transportation and communications projects (loan basis) | 4 6                |                    |                       |
| Reserved for United States use                          |                    |                    | 14 5                  |
| Mission local costs, 5 percent--discontinued in 1956    | 2 9                |                    |                       |
| Local trust fund for technical support costs            | 4 6                |                    |                       |
| Other   | <u>2</u>           |                    |                       |
| Total allocated   | <u>510 8</u>       | <u>116 9</u>       | <u>76 6</u>           |
| Balance   | <u>49 2</u>        | <u>1 6</u>         | <u>4 4</u>            |

## Counterpart deposits

Prior to January 1, 1961, the basis of counterpart deposits was governed by the economic cooperation agreement of 1948 which required counterpart funds to be deposited in an amount commensurate with the dollar costs of imports financed under the aid program. Korea was specifically exempted from section 142(b) (i) of the Mutual Security Act of 1954, which beginning in fiscal year 1955 provided for counterpart deposits in amounts equal to the proceeds derived from the sales of aid-financed imports.

Commodities imported by Korean Government agencies which were not for resale into the economy or for use in revenue-producing activities were not subject to the deposit of counterpart. For all other imports the government-controlled Bank of Korea maintained two separate accounts--a counterpart deposits account, for amounts required to be deposited on the basis of billings by the Mission, and an aid goods collection account, for amounts actually deposited representing local currency of commensurate value paid by commercial importers and revenue-producing government agencies on subauthorizations, and the net proceeds from sales of imported commodities, principally fertilizer, into the Korean economy. ICA and the Korean Government followed a policy of limiting releases of counterpart funds for expenditure to amounts on deposit in the aid goods collection account because expenditures beyond the amounts actually deposited would require deficit financing by the Korean Government with attendant inflationary effects. At December 31, 1960, the undeposited counterpart funds representing the difference between the total credits to the counterpart deposit account and the total collections recorded in the aid goods collection account amounted to 46.8 billion hwan.

Effective January 1, 1961, the basis for depositing counterpart funds was changed to require deposits in an amount commensurate with sales proceeds, as provided in section 142(b)(1) of the Mutual Security Act of 1954. In connection therewith, the Mission designed a new system of accounting for counterpart funds which was intended to do away with the unwieldy and complicated dual accounts under the old system, overcome ineffective control over deposits in the aid goods collection account, and strengthen the accounting and reporting procedures of the Korean Government to provide the Mission with more reliable and extensive information on counterpart operations. These conditions had been the subject of criticism in previous reports by our Office and the agency's Washington office.

#### Budget support for Korean national defense

One of the major purposes of local currency generation has been to support the very large Korean military forces under a program designated as Local Currency Military Budget Support. This program is administered by the United States Military Assistance Advisory Group (MAAG) in Korea. A total of 251.6 billion hwan was allocated to this program through December 31, 1960, from the three sources of local currency. A review of this program will be the subject of a separate report to the Congress.

#### Counterpart loans

Substantial amounts of counterpart funds were loaned to public and private entities for the development and expansion of various sectors of the Korean economy. At December 31, 1960,

counterpart funds released to three Korean Government banks for loan purposes amounted to 112.6 billion hwan, most of which was administered by the Korean Reconstruction Bank. Annual interest rates on these loans were 3 percent prior to completion of construction and generally 8 percent thereafter. Installment collections of principal and interest on loans are required to be deposited to the repayments account of the counterpart fund.

Initially, the recipients of loans were selected by the Korean Government and the Combined Economic Board (CEB); consequently, the banks had little authority in selecting project sponsors and the subsequent loan recipients. In more recent years the CEB authorized individual revolving funds in the banks for specific broad programs, for some of which loans had not previously been available, and designated the banks to investigate the financial resources and credit rating of loan applicants. The results of investigations together with the bank's approval or disapproval were passed on to the Korean Government and the CEB for final decision on the loan application.

Collections by the bank of principal installments and interest are required to be deposited into the respective revolving funds for relending. Annual interest rates averaged 8 percent on long-term loans (2 to 10 years) and 12 percent to 15 percent on short-term loans (6 months to 1 year).

At December 31, 1960, CEB had authorized 39,550 million hwan for the following revolving funds in the three banks:

| <u>Fund</u>                        | <u>Bank</u>                | <u>Amount<br/>authorized</u><br><br>(millions<br>of hwan) |
|------------------------------------|----------------------------|---|
| Operating Loan Fund                | Korean Reconstruction Bank | 2,000   |
| Small Industry Development Program | Korean Reconstruction Bank | 2,431   |
| Housing and Home Development Fund  | Korean Reconstruction Bank | 11,079  |
| Agriculture loans                  | Korea Agriculture Bank     | 16,590  |
| Small industry loans               | do.                        | 1,500   |
| Industry operating loans           | Bank of Korea              | 3,750   |
| Fisheries Revolving Fund           | Bank of Korea              | 200   |
| Export Promotion Fund              | do.                        | <u>2,000</u>  |
| Total                              |                            | <u>39,550</u>   |

The agency advised that in August 1961 the Korean Agricultural Bank was dissolved and its functions and responsibilities were assumed by the new Medium Industry Bank and the National Agricultural Cooperatives Federation.

#### DEVELOPMENT LOAN FUND

Through June 30, 1961, the Development Loan Fund (DLF) had made seven loans totaling \$22 million, primarily for industrial development projects and activities. The operations of the Development Loan Fund have been audited annually by our Office pursuant to the statutory requirements applicable to Government corporations. Audit reports were issued to the Congress for fiscal years 1958, 1959, 1960, and 1961 (B-133220 dated August 31, 1959, February 29, 1960, March 27, 1961, and June 25, 1962).

#### AGRICULTURAL TRADE DEVELOPMENT AND ASSISTANCE ACT OF 1954 (PUBLIC LAW 480)

Korea received significant quantities of United States surplus agricultural commodities (cotton, wheat, barley) under this act. Local currency proceeds from the sale of these commodities under title I have been used for purposes jointly agreed to by the United States and Korea, principally for the support of the Korean military budget, (see p. 60); the remainder has been available to pay United States expenses in Korea.

Commodities furnished under title II are for famine relief or other extraordinary relief requirements. In 1961 commodities valued at \$13 million were allocated to the Korean Government to be used as compensation for workers of the National Construction Service, a public works undertaking of the Korean Government designed to alleviate unemployment.

Title III commodities are donated to approved voluntary agencies for distribution to needy persons.

## ARMED FORCES ASSISTANCE PROGRAM

This program, started in November 1953, was administered by the United States Army and consisted generally of rebuilding schools, public health facilities, orphanages, and similar civil structures.

### INDIRECT AID

The Korean Government has received substantial amounts of indirect aid as a result of payment by the United States for hwan and for goods and services furnished to US/UN forces in Korea, at the official rate of exchange which was about half the market rate. From 1955 to 1960 the United States sold more than \$113 million to the Bank of Korea at the official rate of exchange in return for hwan. The Korean Government then resold the dollars thus obtained to individuals in Korea for hwan at a rate which was generally at least double the official rate.

During the same period the US/UN forces and the ICA Mission paid a total of \$93.5 million for goods and certain services furnished by Korean sources. The amounts paid for these commodities and services were computed at the official rate of exchange and--except for small varying percentages of such amounts which the recipient business firms were permitted to retain--came into the possession of the Korean Government under the exchange control requirements. These dollars were also sold by the government in the same manner as the dollars described above.

The value of utility services furnished to the US/UN forces was also computed on the basis of the official rate of exchange. The dollars for these services were paid by the US/UN to the Korean Government, which in turn credited the government utility agencies in hwan at the official rate. The Korean Government then resold the dollars to Korean importers at a rate much higher than the official rate. The total cost of these services was not readily determinable, except those furnished in 1959 which totaled \$13.1 million.

These several forms of indirect aid ceased in February 1961 when the exchange rate was established at 1,300 hwan to \$1.

### ADMINISTRATION OF THE PROGRAM

#### Bilateral agreements

The economic and technical assistance program for Korea was being conducted under authority of a comprehensive aid agreement, dated February 8, 1961. This agreement superseded the economic aid agreement of December 10, 1948, and, with one minor exception,

the other agreements (described in detail in our prior report) negotiated with the Republic of Korea in connection with the postwar rehabilitation and economic assistance programs.

In our prior report (p. 17), we pointed out that the agreements which then governed the program did not provide for administration of the technical cooperation program which began in Korea in 1956. The new agreement of February 1961 provides for that program.

#### United States Operations Mission

The ICA program in Korea has been administered by the United States Operations Mission in a manner similar to that in which ICA operations in other countries have been administered. In 1959 the Mission superseded the Office of Economic Coordinator (OEC), United Nations Command, which had administered the civilian relief program of the United States Army and then the ICA program. In keeping with the transfer of responsibility for the ICA program from OEC to the Mission, the line of communication, which under OEC had been through the Commander in Chief, United Nations Command, was transferred to ICA channels. The change-over to the normal ICA operation pattern rectified the lack of unified administration which was discussed in our prior report (p. 45).

At the time of our field audit, the Mission employed 257 Americans and 1,059 Koreans. In addition there were 173 Americans and 256 Koreans connected with the United States economic assistance program under ICA financed or administered contracts with professional, educational, and voluntary organizations. The agency reported that, as of November 1961, Mission personnel had been reduced by 12 American and 194 Korean employees and 42 Americans connected with ICA-financed contracts.

#### Combined Economic Board

The Combined Economic Board was established in May 1952 as the result of an agreement between the United States and the Republic of Korea. The CEB, which is composed of the Director of the Mission and the Korean Minister of Reconstruction, is the vehicle through which agreement is reached between the United States and Korea regarding all aspects of the aid program including plans and policies and approval of specific activities. Much of the work of the CEB was conducted through various component committees.

The MOR,<sup>1</sup> which is the Korean counterpart of the ICA Mission, acts as the liaison between ICA and the various Korean ministries and sets forth policies to be followed by those ministries in the conduct of the aid program.

The agency reported in March 1962 that the CEB method of operation had been revamped by agreement between the Mission and the Korean Government, to reduce undue formality, excessive number of observers, and what was judged to be unnecessarily frequent meetings. CEB functions are now carried out informally by the Mission Director and the Chairman of the Economic Planning Board.

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<sup>1</sup>In May 1961, after the change in government, the Ministry of Reconstruction (MOR) became the Ministry of Economic Development (MED) which in turn was succeeded in July 1961 by the Economic Planning Board.



## PROBLEMS IN KOREAN ECONOMIC STRUCTURE

Progress in Korea toward economic stability and self-sufficiency has been and continues to be challenged by serious infirmities in some of the basic sectors of the country's economic machinery. These infirmities, which we discuss below, relate to the poor utilization of Korean resources in foreign exchange and productive capability, the urgent need for a more balanced and productive tax system, the widespread corruption within and outside the government, and the high interest rates on agricultural and commercial loans and the depressing effect thereof on economic well-being and growth.

### NEED FOR MORE PRODUCTIVE UTILIZATION OF KOREAN RESOURCES

United States aid by virtue of its financial magnitude has been bound up inextricably with the Korean economy in the sense that the manner in which certain segments of the economy are administered has a direct bearing on the extent of outside assistance needed. Therefore the United States has a very specific concern in the proper utilization of the internal resources of Korea to the end that the economic advancement of the country is furthered and the need for outside aid is relaxed. Our examination indicated that Korea's utilization of its foreign exchange and productive capability in agriculture and industry, and its administration of civil government operations were not conducive to solid economic development and in some cases were inconsistent with known Korean capabilities or United States agreements or wishes.

### Korean foreign exchange

Korea did not comply with United States-Korean agreements calling for close coordination in the use of Korea's foreign exchange resources. Despite continued evidence that ICA was dissatisfied with the manner in which Korean foreign exchange was being used, it does not appear that ICA made very serious efforts to obtain greater Korean cooperation in this matter. Korea also added substantially to its foreign exchange reserves at the same time that it was requesting additional United States assistance on the grounds that more funds were needed for economic development.

Korean foreign exchange reserves increased from about \$96 million in 1955 to about \$183 million in July 1961, while ICA assistance in recent years has declined to about \$200 million annually. More than half of Korea's foreign exchange earnings were obtained from purchases of local currency, goods, and services by United Nations forces in Korea. The 1952 Economic Coordination Agreement between the United States and Korea, in recognition of the importance of Korean foreign exchange earnings to the country's economic progress, specified that the use of Korean foreign exchange would be coordinated with the use of United States aid funds and

that receipts from United Nations forces would be used only as recommended by the Combined Economic Board, a joint United States-Korean agency. The commodity import program guidelines agreed to annually by CEB called for effective and coordinated use of Korean foreign exchange, and joint United States-Korean financial stabilization agreements provided for the use of dollars received from the United Nations forces in Korea.

Despite these agreements ICA was not able to get Korea to coordinate the use of its own foreign exchange with ICA aid funds. Korean foreign exchange (1) was used for purposes deemed unwise by ICA, (2) was not used for specific commodities which Korea needed to purchase, or (3) was not spent at all and thereby served to increase Korean foreign exchange reserves.

The agency claims that, in spite of limitations on United States control of expenditures of Korean foreign exchange, it has made serious efforts to obtain greater Korean cooperation in careful expenditure of its foreign exchange. The agency agreed that failure of the Korean Government to expend its foreign exchange promptly had contributed to a build-up of Korean foreign exchange reserves and that this build-up had been unexpectedly rapid in the past year because of the slowdown of the Korean economy. The relatively high level of these reserves in 1961 reportedly was of concern to the agency and was discussed with the Korean Government in connection with releases of approved aid funds for the 1962 program.

The agency pointed out that the bilateral aid agreement of February 8, 1961, which superseded previous aid agreements including the 1952 Economic Coordination Agreement, did not include the provisions contained in the 1952 agreement concerning the use of Korean foreign exchange earned from US/UN forces.

#### Use for low priority commodities

For several years ICA officials expressed serious dissatisfaction with the manner in which Korean foreign exchange was being used. In 1957 the Mission informed ICA/Washington that since early in fiscal year 1954 it had been difficult to get Korea to program its foreign exchange for essential commodities. Mission records in 1959 and 1960 indicated that releases of Korean foreign exchange had been made primarily on the basis of pressures exerted on the Korean Government by prominent Korean businessmen rather than for needed items or basic commodities not covered by ICA funding. In March 1960 a Mission internal report stated that Korea was importing goods valued at from \$15 million to \$20 million annually, which, by standards normally applicable to aid recipients, were of low priority and that the balance of Korean imports could stand closer scrutiny. Among the principal imports were nylon and rayon yarns, wool tops, and sugar; also substantial amounts of Korean foreign exchange were reportedly used for watches, radios,

and television sets. (See pp. 113 to 115 for our comments on nylon yarn and wool tops.) The Korean Government recognized that sugar is a low priority item and that the level of sugar imports had been too high. The Mission reported that importers earned a high rate of profit on such commodities as wool tops and nylon yarn and that consequently the Korean Government had been under pressure from influential businessmen to provide Korean foreign exchange for these items.

Despite ICA's continued dissatisfaction with the failure of Korea to live up to its agreements regarding the use of Korean foreign exchange, ICA records did not indicate any serious attempt by United States aid officials to require compliance with these agreements.

The agency position is that it can advocate and even induce curbs on luxury imports but it cannot control the amount of Korean-owned foreign exchange spent on luxury imports under the terms of the mutual assistance agreements. The agency claims that it finances no luxury imports but does permit import of some higher quality goods within approved categories; that, to the extent that it would curtail or eliminate financing of higher quality goods, normal economic pressures would result in their importation through use of Korean-owned foreign exchange over which the agency has little or no control; and that, within the above limits, the agency endeavors to exert its influence on priorities of commodity imports, whether Korean or ICA-financed.

We disagree with the agency's position since it affords no means of assuring that aid funds and the country's own resources will be used for purposes of primary benefit to the advancement of the country's economy. The record of the program over the past years as described in this report, coupled with the very substantial level of aid, emphasizes clearly the vital need for such means. Moreover the implications in the agency's position that Korean-owned foreign exchange and aid funds are separate and distinct elements in the Korean economic framework and that the former should not or need not be subject to strictures on its use and that the use of such foreign exchange should not be within the legitimate province of United States control, are not consistent with economic logic and run counter to the objectives of the aid program.

#### Neglect of essential commodities

At the same time that Korea was using a substantial part of its foreign exchange to purchase low priority commodities, a number of essential commodities either were not acquired or were purchased with ICA funds. For example, ICA financed a major part of the fertilizer required by Korea, and only in 1959 and 1960 did Korea finance a sizable amount of fertilizer with its own foreign exchange. As another example, the Korean Government refused to permit its ministries to spend foreign exchange that they had earned to import spare parts and supplies needed in their income-earning operations. Instead these items were financed by ICA.

### Increase in foreign exchange reserves

A major justification for nonproject aid to Korea was the importation of commodities which were needed by the Korean economy and for the purchase of which Korea's own foreign exchange earnings were insufficient. However, Korea's foreign exchange reserves have increased substantially since the start of the ICA program, indicating that aid funds were used to substitute for or supplement Korean foreign exchange rather than to expand the import of reportedly essential commodities. Between December 1955 and July 1961, Korean foreign exchange and gold holdings increased by \$87 million, or 90 percent over the 1955 level. Some of these reserves were deposited in interest-bearing accounts in the United States and several other countries; annual interest earnings for 1959 amounted to the equivalent of \$3.7 million which is more than 10 percent of all commodity export earnings. ICA informed us that its aid program had not contemplated such an increase.

Despite the large increase in reserves, the United States in March 1961 made a cash grant of \$20 million to the Korean Government, as a stabilization fund against expected reductions in foreign exchange reserves due to the adjustment of the exchange rate. The grant was not necessary for the purpose for which it was made, and in June 1961 there were no definite plans for its use. At that time the grant was on deposit in an interest-bearing account in a United States bank. According to the agency, an economic slowdown prevented the expected increase in demand for dollars. The agency informed us that early in 1962 the use of \$15 million from the stabilization fund was approved for the procurement of fertilizer and other procurement had begun from the remaining \$5 million.

A factor responsible for the increase in Korean foreign exchange reserves was the failure of the Korean Government to sell all the dollars earned by it from transactions with the US/UN forces in Korea. Korean-United States agreements provided for sale of these dollars in order to produce hwan revenues for the Korean Government and to reduce the burden on ICA for financing essential imports. Besides increasing the pressure on ICA aid funds, the failure to use dollars received from US/UN forces resulted in the loss of a recognized source of significant hwan revenues. As we point out in another section of this report (p. 74), the reported shortage of hwan revenues was responsible for failure to make maximum use of Korean production by Korean military forces thereby requiring United States dollar aid to provide from outside sources certain products which could have been purchased in Korea.

As of November 30, 1960, the Bank of Korea reported unsold dollars received from the US/UN forces totaling over \$40 million. If all or a substantial part of this sum had been sold for hwan, the Korean Government would have had a large amount of hwan funds available for military or civilian purposes for which aid funds were used directly or indirectly.

### Korean production capability not utilized

One of the basic purposes of the aid program in Korea has been to provide those commodities and services which the country is unable to produce, acquire, or otherwise provide from its own resources. To a significant extent, however, aid funds under the economic and military assistance programs were used to import commodities which could have been produced in Korea. Failure to utilize this productive capacity caused higher dollar costs to the United States than were necessary.

Imports of cotton under the ICA aid and Public Law 480 programs and soybeans under both the ICA and the MAP programs have been responsible in large measure for reducing Korean production of these commodities. ICA and MAP have discontinued the financing of soybean imports with United States funds. The financing of cotton imports has continued at high levels and, as the Korean textile industry expanded, imports of raw cotton have increased. According to the agency the importing of more expensive finished and semifinished cotton products was eliminated. Furthermore, the MAP program was financing the purchase of material for the Korean military forces which could be produced by Korean industry. Increased procurement from Korean sources would assist in the development and stimulation of local industry, which is a major objective of the mutual security program in Korea.

### Cotton

Obligations for cotton imports under the ICA economic assistance program totaled \$176.6 million through fiscal year 1961, or about 10 percent of the entire ICA aid program. In addition, the United States financed \$52.9 million worth of cotton under titles I and II of Public Law 480.

Cotton has been grown in Korea for hundreds of years; during the Japanese occupation stress was placed on expanding Korean cotton production and a textile industry was gradually established. Korean cotton production has greatly decreased since the advent of the ICA aid program; in 1954 Korea produced 104 million pounds of cotton and in 1959 only 54 million pounds, while United States-financed imports increased from \$18.8 million in 1954 to \$34.6 million in 1959. Costs of United States cotton to Korean textile manufacturers were substantially lower than the cost of Korean-produced cotton. As a result, Korean cotton is currently used mostly for homespun goods in rural areas, since the textile manufacturers can earn greater profits by using United States-financed cotton.

One major objective of the ICA program in Korea has been to reduce rural poverty and increase the income of farmers by diversifying their production and reducing their dependence on rice.

Despite this objective and a Korean Government request to keep agricultural commodity imports at a minimum level in order to develop Korean agriculture, the United States has continued to finance a high level of cotton imports. The Korean Ministry of Agriculture has recognized the need to promote Korean self-sufficiency and reduce dependence on outside aid and has recently announced a plan to increase Korean cotton production.

The agency claims that although cotton has been produced in Korea for many years its production has not been profitable because the climate and soil are not suited to growing quality cotton and that Korean cotton cannot be used to spin commercial goods but is limited mainly to padding for winter clothing and stuffing for mattresses and quilts. The agency further claims that while Korea could grow more cotton such additional production would replace needed agricultural production which makes a greater economic contribution to Korea's needs.

However, according to information obtained at the Mission, Korean cotton has been used in Korean textile plants. About 100 million pounds were produced annually for the textile industry in the period from 1937 to 1944; between 1950 and 1954 substantial quantities were used in Korean textile plants, and in 1955 CEB approved the use of local currency to purchase Korean cotton for the textile industry. Moreover, during the Japanese occupation Korean cotton was used by the textile industry to manufacture cotton sheeting for export to Japan and other countries.

We were also informed at the Mission that concentration by United States agencies on the disposal of United States cotton in Korea to alleviate the United States cotton surplus problem was a factor in the decline of Korean cotton production.

### Soybeans

Korea is known as the "home" of the soybean, this crop has traditionally been a major food source for the Korean people. Korea exported substantial quantities of soybeans before the advent of United States aid, since that time soybean production has not kept pace with Korea's increased requirements occasioned by the country's growing population and soybean exports have been reduced to only minor quantities. Soybean yields per acre are reported to be lower in Korea than in any other principal soybean-producing country, and both the yield per acre and the total production have declined from the level existing prior to the start of the ICA program. Although ICA technical studies show that the application of fertilizer, and the use of other improved agricultural practices, could result in substantial increases in soybean yields, fertilizer, though a major component of the ICA program, was not allocated for soybean production until 1961.

Since 1957 large quantities of soybeans have been imported into Korea under the military assistance program for consumption by the Korean armed forces. In May 1960, ICA persuaded United States military authorities to terminate soybean imports for the Korean military forces. However, a month later ICA authorized \$1 million for the importation of soybeans as part of the economic aid program. Since imports under the military assistance program were considered by ICA a disincentive to Korean production, it is difficult to understand why ICA permitted the importation of soybeans under the economic aid program after it had requested termination of military assistance imports. An ICA study dated August 1960 estimated that substantial quantities of soybeans imported under the military program had been diverted to civilian use and that this diversion had a depressing effect on the Korean economy. ICA justified the \$1 million authorization by citing the need to meet an immediate requirement for soybean oil. However, only \$530,000 of the authorization was taken up by Korean importers over a period of about 6 months; the authorization was extended several times; and the balance of \$470,000 was finally deobligated in February 1962. It appears from these events that there was little if any need for the issuance of this authorization.

The agency informed us that it recognized the potential of Korea for increased soybean production and that the Korean Ministry of Agriculture had recently taken action to increase production; however, the Ministry had not requested ICA assistance in this matter.

ICA stated that its policy directive concerning agricultural production prohibits the use of aid funds to increase foreign production of cotton and other nonfood agricultural products that are in world surplus. In the case of Korean cotton, however, it would appear that an increase in production would not necessarily conflict with the policy because:

1. Decreased financing of cotton imports would enable a reduction in United States aid and would most likely tend to increase Korean cotton production.
2. The present level of Korean cotton production is significantly below the level existing at the start of the ICA program and prior to the Korean war. Therefore restoring production to its former level should not be considered as an increase, particularly since one of the objectives of the ICA program is to restore Korea's economy to pre-Korean war levels.

It should also be noted that, despite the ICA policy directive, ICA-financed fertilizer has been allocated to Korean cotton, although by so applying fertilizer United States assistance is

being used to increase the production of this crop which is in world surplus.

The plans of the Revolutionary Government call for a 200-percent increase in cotton production. The government also expects an increased local demand for soybeans due to population increases.

#### Material for Korean military forces

Military assistance funds were used to finance the import of commodities for the Korean military forces, which are produced by Korean industry.

The United States Country Team in Korea--which is headed by the Ambassador and includes the Director of the ICA Mission and the Commander in Chief, United States Forces Korea--decided in 1960 that commercial-type material previously furnished to the Korean military forces under the military assistance program would be shifted over a period of years to the Korean military budget. Beginning in 1961 clothing and certain food items for use of the military forces, which had previously been imported, were procured from Korean sources. This shift was designed to permit the Korean military forces to procure more of their own requirements locally and thus assist in the stimulation of local industry.

At the time of our review it was evident that Korean industry was able to produce many of the items still being imported for the use of Korean military forces under the military assistance program. Korean-made products such as tires, tubes, paint, drugs, biologicals, and medicines were not being used by Korean military forces or being paid for by the Korean Government, but instead were imported and paid for from United States MAP funds. The same situation is true of products available from Dae Han Shipbuilding Corporation, discussed on page 144

An annual target of 10 billion hwan was set by the Country Team for the transfer of items from the military assistance program to the military budget. We were informed by ICA officials that this target was based both on the technical potentiality of the Korean economy and the projected availability of local currency to support this budget. The United States was supporting approximately 95 percent of the 1961 Korean military budget with hwan generated by the sale of commodities financed by the economic assistance program and by the sale of surplus agricultural commodities financed under Public Law 480.

ICA wanted to limit the amount of procurement transferred to the Korean budget to the annual target of 10 billion hwan so that local currency (hwan) would continue to be available in the



required amounts for economic development activities. We were informed by the agency that in the fall of 1961, as a result of an economic slowdown after the revolution, counterpart accumulations failed to build up at the anticipated rate and an interagency agreement was reached, recognizing the unavailability of additional hwan for military budget support, so that the MAP transfer program was suspended for 1962

While ICA must take into account the amount of local currency available to support the Korean military budget and to achieve other United States objectives in Korea, aggressive effort in tax reform (p. 78) and collection of full counterpart funds (p. 152) would increase local currency revenues and gradually enable additional procurement of locally available commodities for the Korean military forces.

#### Review of Korean civil budget

United States aid to Korea has been based in part on the need to secure local currency, over and above the revenues of the Korean Government, for support of Korea's military budget and for economic development activities. The United States has a direct interest, therefore, in the use that the Korean Government is making of its own local currency revenues and the degree of economy with which governmental operations are carried out.

ICA officials reported that the Korean Government resisted any efforts to review or influence the preparation of the civil budget. United States military authorities review and advise on the formulation of the Korean military budget.

ICA was able as a part of its advisory effort to review the administrative operations of the Korean Office of Supply (OSROK) which handles civil government procurement. ICA studies in June 1960 disclosed that OSROK operations were uneconomical in that certain storage locations rented by OSROK were virtually unused, or were otherwise unnecessary, and that storage rates and cargo-handling charges paid by OSROK were far higher than commercial charges for comparable services. Another ICA study in January 1961 pointed out that improved management and the closing of unnecessary offices could result in savings of administrative expenses totaling about 400 million hwan, or nearly 50 percent of the total amount budgeted for 1960 administrative expenses.

The agency, in March 1962, advised that these studies have had some influence in improving OSROK operations. As of October 31, 1961, OSROK, by closing all provincial offices, reducing port personnel to reasonable requirements, and reorganizing the main office, was able to effect personnel reductions of 701 employees from a total complement of 1,064 at June 30, 1961.

The agency agrees that the Mission had little influence with previous Korean Governments in joint budgeting of total resources because these governments considered joint budgeting politically infeasible. The agency claims however that the present Korean Government has made available to the Mission various data on the 1962 budget and has discussed budget problems with Mission personnel but has not permitted Mission inspection of so-called Special Accounts which AID states are areas of the civil budget, the review of which would be especially useful. AID also stated to us that the counterpart budget for calendar year 1962 reflects Mission views regarding priority investment sectors and that the Mission had had a meaningful influence on the allocation of total counterpart resources.

### Recommendations

The full and most productive utilization of Korean resources and capabilities is essential to the country's economic development and is of deep interest to the United States since the manner of such utilization has a direct bearing on the extent of outside assistance needed. Accordingly, and on the basis of the considerations discussed above, we recommend that the responsible United States agencies:

1. Negotiate with the Korean Government to amend the bilateral agreement of February 8, 1961, to require the use by the Korean Government of Korean foreign exchange earned from US/UN forces in the manner prescribed in the 1952 Economic Coordination Agreement.
2. Review the proposed use by the Korean Government of its foreign exchange and exert some degree of influence regarding such use, particularly as to the types of commodities to be imported, the amount of foreign exchange to be used, and coordination of use with commodity import aid funds.
3. Reexamine current policy with respect to the use of aid funds for increasing the production of agricultural products in world surplus in the light of the circumstances applicable in Korea as outlined above. Such reexamination should be addressed principally to the consideration of whether or not (a) the circumstances in Korea were intended to be included in the current policy and (b) increased production of cotton and soybeans would be in the best long-range economic interests of Korea, particularly in view of the attitude and plans of the Korean Government, and relatively less detrimental to the United States interests as contemplated by the policy.
4. Consider all feasible actions that will encourage and permit maximum local procurement of items for the Korean

military forces that can be obtained in Korea, as a means of strengthening and developing industry within Korea.

5. Intensify their efforts to review all significant segments of the Korean civil budget in the course of its formulation or prior to its finalization and exercise an effective advisory role in the determination of amounts to be budgeted for the respective civil functions.

## NEED FOR TAX REFORM

An inequitable tax system, combined with an unsound collection structure and ineffective administration by the Korean Government, has greatly hampered economic growth in Korea and by reason thereof has contributed to the continued need for substantial outside assistance. ICA recognized the urgency of comprehensive tax reorganization as a means to increase government revenues, overcome widespread tax evasion and other illegal practices, encourage business activity, and attract foreign investment. Technical assistance initiated in 1959 through an ICA-financed contract was terminated by the contractor before completion of the contract work. At the conclusion of our field review, ICA was endeavoring to recruit two tax advisors in response to request of the Korean Government for assistance in the tax field. The Revolutionary Government recently announced a new tax reform plan which would drastically modify tax revisions recommended by the contractor prior to its withdrawal and enacted into law by the previous Korean Government. The contractor in its final report stated that, until such time as satisfactory tax reform was accomplished, economic growth and development of Korea would be stultified.

### Contract for study of tax reform

Since the inauguration of the Republic of Korea in 1948, the country has had eight separate tax reforms, however, none of these reforms has been sufficiently comprehensive and effective to put the country on a sound tax basis. In 1959 ICA executed a contract with a United States nonprofit institution to assist the Korean Government in reforming its tax structure. The contract was for about 2 years but was terminated by the contractor after only about a year of effort by its full field staff. This matter is discussed further on succeeding pages of this section.

Some of the principal characteristics of the Korean tax system, as described in the final report of the contractor and other data available to us, are summarized below.

1. Certain tax rates, particularly personal and corporation income taxes, have gone beyond their optimum levels, with the result that they have induced an even larger order of tax evasion. According to the contractor excessive rates of taxation compelled those in industrial and business activity to engage in wholesale tax evasion as a means of economic survival. The Revolutionary Government, which came into power in May 1961, reported that tax evasion was a common business practice and was in fact a prerequisite for staying in business and also that the illicit accumulation of wealth which was a major cause of two governmental overturns was actually rooted in the tax system.

2. The extensive use of the arbitrary assessment rather than self-assessment (the preparation of income tax returns by taxpayers in the United States constitutes a self-assessment system) leads to taxpayer-tax official collusion which in turn results in loss of revenue to the public treasury. The contractor reported that apparently there was an organized program of collecting bribes from taxpayers in return for reductions in arbitrary assessments.
3. Despite reported widespread collusion between taxpayers and tax officials, there appeared to be unjustifiable administrative leniency with respect to the dereliction of tax officials.
4. A shift from direct taxation (i.e. personal income taxes) to indirect taxation (i.e. commodity taxes) would tend to reduce consumption and encourage a higher rate of capital formation.

The contractor's final report, rendered in November 1960, stated the opinion that economic progress in Korea was dependent upon a tax environment which would induce and encourage savings and capital formation and that, until such an environment was created, economic progress in Korea would be stultified. ICA informed us that there was a need for domestic capital to assure the utilization of capital goods financed by aid funds.

The services under the contract contemplated a work program in three stages, as follows:

1. Revise national, provincial, and local taxes.
2. Reorganize the administrative structure, functions, and personnel of the Korean Taxation Bureau.
3. Break the chain of fraud which existed with respect to taxpayers and tax officials.

In the time that the contract group worked in Korea it drafted 13 tax law revisions, all of which were enacted into law by the then Korean Government during and subsequent to the tenure of the group in Korea.

The staff members of the contract group objected to the revisions submitted by the group's director because the revisions were too closely modeled on American laws, and not suited to Korean conditions, and had not been sufficiently studied by the group prior to their recommendation to the Korean Government. Although the ICA Mission informed us that the tax law revisions enacted by the Korean Government significantly contributed to

positive tax reform and were essential to economic growth, the Mission subsequently informed us that, as a result of the objections of the contractor's staff members to the revisions proposed by the group's director, it had doubts as to the validity of these laws. These doubts were confirmed by the proposed plan of the Revolutionary Government to make a thorough overhaul of the entire tax structure of Korea by abolishing or merging 21 different types of taxes into 8 new types and readjusting the collection authority between national and local governments.

The program contemplated under the contract was not completed at the time the contractor withdrew, primarily in regard to tax collection practices and other phases of tax administration. We were informed by ICA officials that the Revolutionary Government had requested assistance in improving tax administration and that ICA was endeavoring to recruit two tax advisors. At the time of our review, ICA recruitment efforts had not been successful and no assistance was being given the Korean Government in this area.

The agency advised that one tax administration advisor had been sent to Korea early in 1962, that the Korean Government had intensified its own efforts in the field of taxation and administration, and that on January 1, 1962, substantial changes in the tax structure of the nation became effective to accelerate the development of the national economy and to provide for a more efficient tax administration, in particular the elimination of corrupt practices and taxpayer-tax official collusion.

#### Withdrawal of United States contractor

The contractor began operation in Korea under a letter of intent dated May 29, 1959, which was superseded by a formal contract dated November 20, 1959, for about a 2-year period. The contract staff began arriving in June 1959 and by December was up to full strength of six persons. In August 1960 the contractor notified ICA of its intent to terminate the contract, and all contract activities were concluded by November 1960. The contractor gave the following reasons for its decision to terminate the contract.

1. Dissension within the contract staff.
2. Unsatisfactory relations between the contract staff and some Koreans in the Ministry of Finance; however, relations with principal ministry officials were satisfactory.
3. Unsatisfactory relations between the contract staff and the Mission.

The contractor stated that it would prefer to reconstitute the contract staff but, in view of the strained relations within that staff and with officials of the Mission, it could see no way

in which a satisfactory reorganization of the contract staff could be accomplished.

ICA considered that dissension within the contract group was the overriding reason for termination and that this dissension concerned technical differences of opinion as to the type of tax laws to be recommended and the best timing for their introduction. From our review of the contract files, we believe that an important factor in the contract termination was the contractor's dissatisfaction with the administrative support furnished by the Mission, particularly as to motor vehicles. Also, it appeared that there was serious staff dissension about such matters as being required to work on Korean and American holidays and not receiving adequate housing.

In May 1960 the contractor pointed out to ICA/Washington that past disputes with the Mission over the subject of automotive transport had convinced the contractor that unless the problem was solved it would be unwilling to continue the contract. Although ICA/Washington and the contractor had written agreement concerning the use of vehicles, disputes continued over the interpretation of certain provisions of this agreement. The contractor concluded that it was unwilling to have its field staff subject to continued harassment in this respect. In a letter to the American Ambassador to Korea, the contractor stated that it was tragic that an operation of such significance faced probable extinction because of petty housekeeping harassment by the Mission.

We noted that certain of the restrictions applied by the Mission to the contractor's staff were not followed by the Mission for other contract groups or for its own employees. For example, one order to which the contractor objected was that its staff ride busses from their homes to their offices rather than Mission sedans which the group previously had been using. For other contract groups in Korea, sedan rather than bus transportation was provided between housing areas and offices and, despite the availability of bus transportation, many of the principal Mission officials were furnished sedans for such transportation.

ICA expenditures for the services covered by this contract totaled \$183,000, and counterpart funds in the amount of 30 million hwan were also expended in connection with these services.

#### Conclusion and recommendation

It is a matter of major misfortune that such a highly important task as tax reorganization was thwarted by what seem to be petty misunderstandings. It would seem that the presence of the contract group in an effective capacity would have been especially helpful at the time that the Revolutionary Government announced its plans for tax reform since these plans in some respects appear

to be inconsistent with tax revision laws proposed by the contract group and enacted into law. In view of the paramount importance of effective tax reform to the success of United States aid in Korea and the interest manifested by the Revolutionary Government in obtaining assistance in this area, we recommend that AID augment its current assistance in order to accelerate the establishment of a sound and effective tax system.

Tax revenues lost through  
disproportionately low tax rate on gasoline

While certain direct taxes, such as income taxes, were considered to be too high, certain indirect taxes, such as commodity taxes, may have been too low.

Because of the low tax rate on the sale of motor vehicle gasoline, the price of gasoline sold to civilian users in Korea was considerably below gasoline prices in other non-gasoline-producing countries, with the result that tax revenues on sales of gasoline were substantially less than could reasonably have been assessed.

All legal supplies of motor vehicle gasoline used by the civilian economy were financed by ICA.<sup>1</sup> The price at which the gasoline was sold to the users comprised (1) the hwan equivalent of the price paid to the gasoline suppliers by ICA (about 10 cents a gallon), (2) customs tax and commodity tax, and (3) certain handling charges and profit allowed to the gasoline distributors. Until January 1961 the commodity tax rate applicable to gasoline was at a level which permitted gasoline to be sold at a much lower price than the price at which gasoline was sold in other non-gasoline-producing countries. For example, selling prices per gallon based on official rates of exchange prior to January 1, 1961, were in France, 78 cents; Italy, 75 cents; Taiwan, 55 cents; Japan, 50 cents; Philippines, 46 cents; and Korea, 40 cents. ICA continued financing gasoline without requiring a more adequate tax rate despite its recognition that a higher tax rate would help to achieve its aim of discouraging nonessential consumption. It was not until January 1961, when the commodity tax on gasoline was doubled and the official hwan-dollar exchange rate was revised, that gasoline prices in Korea were brought into line with the gasoline prices in Japan; however, prices were still below the level of those in France and Italy. We understand from the agency that the tax rate on gasoline has been further increased by 50 percent of the rate adopted in January 1961.

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<sup>1</sup>For discussion of illegal supplies of motor vehicle gasoline, see page 117.



Because of the low tax rate, substantial potential tax revenues were lost to the Korean Government, thereby adding to the pressure for higher United States dollar aid. We estimate that if the tax rate established in January 1961 had been in effect in 1959 and 1960, and assuming the same authorized consumption levels, additional taxes in the hwan equivalent of approximately \$30 million would have been earned.

## CORRUPTION IN KOREA

It has been widely recognized by United States authorities that large-scale corruption within the Korean Government, principally since 1953, has been a major deterrent to economic progress in Korea. According to the Revolutionary Government, corruption and inefficiency were largely responsible for what it considered a condition of economic stagnation in the country but aid provided by the United States and the United Nations was, in general, wisely and efficiently expended. In its report "New Directions in the National Economy," dated July 1961, the Revolutionary Government identified corruption in certain sectors of the economy as being of significant gravity.

1. Agricultural cooperatives and the Agriculture Bank, in handling the release of farm credits and fertilizer under the government distribution program, took benefits due farmers and made them pawns of politics.
2. State-operated businesses provided political funds to politicians in power.
3. Most aid-imported raw materials were allocated to owners of plants (designated end-users) and under the low-pegged exchange rate they were able to make fantastic profits.
4. Only a privileged few had access to bank credit, and businessmen had to turn to usurious private money lenders. Many entrepreneurs went into collaboration with politicians and bureaucrats. Bankers issued illegitimate loans in connivance with politicians and ranking government officials.
5. Because of prohibitively high tax rates and arbitrary assessment by tax officials, the keeping of two sets of books was a common practice and tax evasion was necessary to stay in business.
6. Misconduct and abuses by government officials reflected low moral and disciplinary standards which were attributable in large part to low government salaries.

The Revolutionary Government further reported that preliminary investigations had disclosed a total of 72.6 billion hwan in illicit wealth accumulated since July 1953 and that one group of 13 businessmen publicly acknowledged tax evasion in the equivalent of more than \$33 million and volunteered full restitution plus penalties.

ICA followed the usual programing and administrative control practices that are common to most country aid programs. These

practices consisted generally of (1) end-use audits of commodities and projects financed from dollar and counterpart funds, (2) technical assistance in projects of public administration designed to improve budgeting, accounting, auditing, reporting, and methods of assessing and collecting taxes, (3) advisory service on supply management including preparation of specifications and bid invitations, screening bids, and awarding contracts, and (4) investigation, by the regional inspector of the Office of the Inspector General and Comptroller, of specific cases where fraud was suspected. ICA advised us that, in addition to these practices, with specific reference to the Korea program it had encouraged the establishment of rate commissions and other regulatory-type activities and urged the inclusion in the Foreign Aid Control Law of a requirement that adequate records be kept by importers, distributors, and retailers and that the adoption of a unitary exchange rate in February 1961 which was sponsored by the responsible United States agencies closed the avenue to many forms of corruption.

The audit and investigative practices mentioned above are directed to the utilization of aid funds only and do not encompass practices and actions within the Korean Government having to do with Korean funds or other resources. It seems clear that, whether or not aid funds are directly involved, the consequences of corruption on the economic vitality of the country diluted the effectiveness of the aid program. These factors, the apparent recognition of the existence of extensive corruption over a period of years, the substantial annual level of aid, the unhealthy state of the economy, and the known questionable integrity of the political structure added up to a set of circumstances which seemed to us of such extraordinary character and of such potentially serious financial jeopardy to the economic objectives of the aid program as to warrant some special effort by the responsible United States agencies. The aim of such effort as we see it would have been to ascertain some specifics as to the dimensions of corruption, the economic sectors in which it was present; and the deficiencies in policies, practices, procedures, and related control effectiveness which would facilitate or encourage corruption, and to pursue a vigorous course of frequent and strong confrontation of the Korean Government within the farthest limits of foreign policy. The record does not evidence that such effort was made, and it was apparent from our discussions with responsible Mission officials that they believed that adequate action had been and was being taken, that ICA responsibility extends to the proper use of aid funds only, and that corruption is an internal problem the mitigation of which depends primarily on the sincerity and vigor of the Korean Government.

In the course of our review of this subject, our representatives met with the Chief of the Investigating Committee of the Revolutionary Government and apprised him of our interest in the investigations by his committee and also initiated discussion

regarding access to investigation and audit reports of the Korean Board of Audit. This discussion subsequently led to arrangements between the Board and the Mission for the exchange of audit reports. The investigation reports were not completed at the time of our meeting, and we suggested to the Mission that it follow up to obtain copies of such reports for use in familiarizing itself with the results of the investigations and the remedial administrative measures that seemed to be indicated.

#### Agency comments

The agency agreed that the above presentation is a substantially unbiased statement on corruption in Korea and that the actions recommended below are generally moderate. It requested, however, that reference should be made to (1) repeated Mission studies of corruption in Korean government and business activities, (2) Mission efforts to eliminate corruption through training of government officials in public administration and through audits, and (3) the traditional acceptance of corruption in Korean life. The agency also called attention to the referral, by the Office of Inspector General and Comptroller, to the Korean Government agencies, of significant matters investigated over the past 2 years and to the difficulties involved in Mission exploration of corruption in Korean sectors beyond the aid program.

The first two of the above references are part of the regular activities carried on in most aid-receiving countries and are encompassed in the description of these activities on page 85.

#### Conclusion and recommendation

We cannot say what if any beneficial results might have been realized if the responsible United States agencies had instituted any special effort such as we have suggested. It is reasonable to believe that such an effort would at least have had the salutary effect of demonstrating to the Korean authorities, more convincingly than general discussions, the sharp dissatisfaction of the United States and the danger to the aid program. It seems to us, however, that the attitude of ICA has been narrow and passive. In the light of the very sizable aid investment in Korea and the essentiality of economic and political integrity and efficiency to the effectiveness of that aid, the United States has a very direct concern with all workings of the Korea economy.

We further believe that this concern should be manifested in positive action by the responsible United States agencies to the end that corruption may be minimized with resultant benefit to economic advancement in Korea and the purposes of the aid program. In line therewith, we recommend that these agencies (1) apprise themselves of the specific nature and extent of corruption and inefficiency in Korea through review of government investigative and audit reports and such other means as may be necessary and

feasible, in order to identify the sources of problems and the impact thereof on the aid program, (2) determine by direct examination or through cooperative action with the responsible Korean audit agency the adequacy of management policies and controls in the respective Korean operating agencies and follow through for such improvements as may be indicated, and (3) maintain on a continuing basis regular contacts at the highest levels of the Korean Government to evidence clearly the deep and sustained concern of the United States about corruption and inefficiency as they affect the intended benefits of the aid program and to give the impetus of high authority to positive action on corrective measures.

## EXCESSIVE COST AND UNWISE USE OF INVESTMENT FUNDS

Extremely high interest rates in Korea on agricultural and industrial loans impeded efforts to channel funds into productive uses and thus retarded development of the economy. The high rates were attributable mainly to the insufficiency of capital in Korea and the fundamental deficiencies in the traditional banking and monetary structure. These conditions fostered the accumulation of funds outside regular banking institutions and the making of loans to farmers and private business at usurious interest rates. The consequences perpetuated a state of heavy debt, low living standards, and minimal purchasing power in the agricultural community, which comprises more than half the country population, and channeled funds into nonbasic but profitable enterprises rather than essential industrial undertakings, thereby discouraging industrial growth.

It appears that ICA considered its function in the field of loan capital and interest rates as one of advice and encouragement on basic monetary and economic reforms. Mission officials stated to us that their work over the past years laid the foundation for the emergency measures instituted by the Revolutionary Government to relieve the farmers from their oppressive debt burden and to release additional funds for industrial loans in the small and medium industry sector

Recent estimates by the Korean Government indicate that rates in the unorganized money market ranged between 4 percent and 6 percent per month. The importance of the unorganized money market in providing funds is evidenced by surveys conducted by the Bank of Korea and the Tax Bureau of the Korean Government which showed that the dependence of enterprises upon private loans is generally higher than upon bank loans.

Since Korea's financial structure could not collect people's savings effectively nor distribute them to each economic sector adequately, unique institutions evolved which are generally unknown in other countries. Thus "Kye's," or household mutual loan organizations, were developed to promote good will among participant families, to provide mutual support, and to perform the functions of savings institutions. An analysis by the Bank of Korea of the reasons underlying the prosperity of the "Kye's" illustrates at the same time the fundamental deficiencies in the prevailing organized banking and monetary structure. These deficiencies include the following factors.

1. There has been no way of compensating for the depreciation of currency as a result of inflation, through the relatively low interest rates obtainable on deposits in commercial banks.

2. Government budget deficits necessitated the enforcement of a tightened financial policy and financial facilities have been difficult to obtain for enterprises.
3. Compared with the high rate of incremental profit on the investment of capital, interest rates on deposits with banking institutions, particularly on fixed deposits, have been extremely low.
4. The lack of public confidence in enterprises and the distorted interest rate structure have made it impossible for enterprises to obtain private investment funds directly by sales of stocks or debentures.

ICA also pointed out that essentially the establishing of interest rates had become an attempt to estimate the risk element and to hedge against continued dilution of the purchasing power of money rather than the fixing of a charge for the use of funds for productive use and that this disparity was recognized as a potential source of corruption and misappropriation of resources. This disparity and its incentive to corruption as reported by the Revolutionary Government are described on page 84. Further economic effects reported by the Revolutionary Government were:

1. Farm prices were kept at levels considerably lower than other prices with the result that farmers hardly managed to recover the actual cost of production and, in the end, lost the will to produce. Even when there was a will, efficient farm operation was hampered by shortage of funds and farmers were frequently compelled to resort to usurious loans or to the practice of mortgaging rice crops before harvest.
2. The impoverishment of the rural economy reduced the purchasing power of the domestic market for products of small- and medium-sized industries, and these industries came to suffer from inventory surpluses. Only one tenth of the government funds available for investment and loans to the private sector were allocated to these small- and medium-sized industries, and no other measures were taken to aid these industries.

While precise information as to the magnitude of capital shortage in Korea is difficult to come by, several estimates have been made which serve to illustrate the seriousness of the imbalance between funds available through regular banking channels and capital requirements. Statistics compiled by the Agricultural Bank showed that the debts of the rural population in Korea reached a total of about 95.6 billion hwan as of September 1960. Regarding the industrial sector, the Korean Reconstruction Bank

estimated a requirement of 33 billion hwan for working capital loans on the part of only those firms which the bank had assisted by means of long-term loans.

As one of the first emergency measures taken by the Revolutionary Government upon assuming power, a decree was issued which provided, among other things, that:

1. Debts of farmers or fishermen that carry an interest rate of more than 20 percent a year shall be defined as usurious.
2. Usurious loans shall be suspended.
- 3 Both creditors and debtors shall report their usurious money deals.
4. Usurious debts shall be screened with the government and after clearance shall be guaranteed by the government on an annual basis and repaid by the debtors.

ICA informed us that in accordance with the foregoing decree a total of 50 billion hwan was reported to the government as usurious debts.

Additional emergency measures taken in July 1961 to speed economic development included (1) the release of additional funds for agricultural production credits, (2) the granting of loans to farmers through liens on agricultural products, with the release of these loan funds in advance to obviate the practice among needy farmers of selling rice crops before harvest, (3) the merging of agricultural cooperatives with the Agricultural Bank, and (4) the release of loans to about 1,000 small and medium industry firms for working capital needs.

In the banking field the emergency measures involved (1) the promulgation of a law drastically restricting the voting powers of large stockholders and emphasizing the public responsibilities involved in banking, (2) raising interest rates on time deposits by 50 percent in an effort to reduce the gap between bank and curb rates and to discourage hoarding and attract savings into banks, (3) reduction of reserve requirements in order to expand lending capacity, and (4) initiation of plans for the establishment of a small and medium industry bank.

In general ICA concurred in the emergency actions undertaken by the new government, as being in the direction pointed out to previous governments over a period of time. ICA in recent years sponsored the creation of several loan funds (by allocation of counterpart funds) in the Korean Reconstruction Bank, Korean Agricultural Bank, and the Bank of Korea.



It is obvious that the efforts of previous Korean Governments and of ICA were not sufficiently effective to (1) assure an adequate flow of capital to the agricultural and industrial sectors of the economy, (2) appreciably reduce market interest rates as a means of facilitating the flow of resources into productive uses to further economic development, and (3) provide a necessary stability and confidence which would attract needed funds into time deposits in the regular banking institutions.

From our discussion with responsible Mission personnel it appears that the Mission viewed its role as one of providing advice and of being a "catalytic agent" on getting the Korean Government to undertake needed monetary and economic reforms. Thus, while the Mission did not participate in the drafting of the emergency measures previously referred to, it claims that the groundwork for these measures was laid over a period of time in the many discussions and programs initiated under the guidance of Mission advisers. For example, the Mission pointed out that the current over-all program of rationalization of interest rates is traceable to early 1960 discussions prefacing and accompanying the normalization of exchange rates.

#### Conclusion and agency response

The policy of ICA as indicated above was addressed to broad basic concepts in which its efforts were calculated to realize permanent benefits over a long period. This policy was not adapted to dealing with immediate problems and suggests the question of whether some or all of the conditions against which the emergency measures of the Revolutionary Government were directed, particularly those to relieve the financial plight of the agricultural community, could have been alleviated by ICA and previous Korean Governments if the policy of ICA had been geared to meeting existing demands for short-range benefits as well as formulating and sponsoring fundamental long-range reforms. There would seem to be no question, however, that the continuance over a number of years of insufficient loan funds and prohibitive interest rates obstructed in significant degree the forward movement of the Korean economy.

The agency advised us in March 1962 that banking and financial advisers were recently sent to Korea to review the total fiscal problem, inflationary aspects of new investment, and credit institutions; also that progress made during the summer and fall of 1961 by the Revolutionary Government in attacking usurious creditors, creating a new Industry Bank, and examining ways of making more and lower cost capital available to various sectors of the economy has been in conformity with AID concern for action in this area.

## COMMODITY IMPORT PROGRAM

The commodity import program has been the largest segment of the aid program, aggregating \$917.6 million for the 5 years, 1957-61, and \$1,342.7 million since the termination of Korea hostilities in 1953. The nature of the program and the operating procedures are described beginning at page 57. Our examination disclosed various conditions which we believe very significantly hampered the progress of the aid program. They deal with the shift in imports from capital to consumable goods, the unwise loosening of control by ICA over the types of commodities imported, collusive bidding for ICA funds, the financing of industrial enterprises as nonproject aid and the unsound administration thereof, defective practices followed in the fertilizer program, the encouragement of luxury wants, and avoidable shortages in gasoline and automotive spare parts which were responsible in large part for pilferage of military supplies. Each of these conditions is discussed in the succeeding sections.

### CHARACTER AND CONTROL OF COMMODITY IMPORTS WERE NOT CONDUCTIVE TO ECONOMIC DEVELOPMENT

In recent years an increasing proportion of ICA commodity import assistance was devoted to consumable goods despite Korea's need for capital investment. Significant amounts of ICA funds were earmarked for comparatively low priority consumer goods or at the time of our review were not being used while essential activities, such as power development, were delayed or not undertaken. Moreover, as a result of revising its procurement authorization practices in 1961, ICA had less control over the commodity composition of the import program and hence less means of channeling available resources into those areas which would provide the greatest impetus to economic growth.

#### Shift to consumable goods

Responsible United States officials have stressed that a viable economy in Korea can be achieved only by capital investment which will enable Korea to produce the goods required for internal consumption and for export in order to earn the foreign exchange needed to pay for essential imports. Korea lacks the funds for necessary capital investment but, if foreign aid funds were used to the fullest possible extent to provide capital facilities, increasing progress towards economic development may be achieved. Despite this acknowledged fact, the ICA program in Korea tended increasingly in recent years toward financing consumable goods which, when consumed, left Korea in relatively the same position as before the aid was extended and did not contribute to economic advancement.

The following table shows the increasing trend in the use of ICA funds for financing consumable goods.

|   |  | <u>Obligations in fiscal year (note a)</u> |                |                |                |                            |
|---|--|--|----------------|----------------|----------------|----------------------------|
|   |  | <u>1957</u>                                | <u>1958</u>    | <u>1959</u>    | <u>1960</u>    | <u>1961</u>                |
|   |  | (millions)                                 |                |                |                |                            |
| Investment-type goods:  |  |  |                |                |                |                            |
| Project   |  | \$ 97.4                                    | \$ 42.3        | \$ 45.6        | \$ 30.2        | \$ 11.6                    |
| Nonproject (includes machinery and consumable-type goods used for investment) |  | <u>36.5</u>                                | <u>25.6</u>    | <u>41.0</u>    | <u>47.0</u>    | <u>25.5</u>                |
| Total   |  | <u>\$133.9</u>                             | <u>\$ 67.9</u> | <u>\$ 86.6</u> | <u>\$ 77.2</u> | <u>\$ 37.1</u>             |
| Consumable goods:   |  |  |                |                |                |                            |
| Nonproject  |  | <u>\$173.6</u>                             | <u>\$151.8</u> | <u>\$142.6</u> | <u>\$135.6</u> | <u>\$134.5<sup>b</sup></u> |
| Ratio of consumable goods to investment-type goods                            |  | 1.3  | 2.2            | 1.6            | 1.8            | 3.6                        |

<sup>a</sup>Adjusted to December 31, 1960, except that 1961 obligations are as of June 30, 1961.

<sup>b</sup>Does not include cash grant of \$20 million given to Korea in 1961, for which no firm plans had been developed at June 30, 1961.

In 1959, the Director of ICA stated that the agency's general policy for Korea was to use a greater proportion of aid funds for capital development while reducing the amounts devoted to consumer goods. In 1960 and 1961 the American Ambassador to Korea stressed the necessity of capital investment if Korea was to achieve self-sufficiency. In 1960 the Department of State, in reporting to the Congress on the prospects of various aid-receiving countries' becoming self-sufficient, stated that in the case of Korea a larger proportion of aid funds would be spent for capital goods. In October 1960 the Korean Government, recognizing the need for increased capital investment, requested that the emphasis of the aid program be shifted from maintenance of consumption to accelerated investment in order to achieve growth and a viable economy. The Mission Director in April 1961 acknowledged the need for capital investment while pointing out that foreign exchange available to Korea for that purpose was insufficient.

Nevertheless, the ICA program in 1961 increased the ratio of consumable goods in the aid program. The significance of this increase was heightened by a change in ICA procurement authorization practice which permitted the Korean market a choice as to whether

or not the very limited funds earmarked in the past for capital investment would be used for that purpose or for additional consumable goods. (See next section.)

At June 30, 1961, approximately \$51.7 million obligated in 1961 and \$1.6 million obligated in 1960 had been available, at the Bank of Korea, for some time to Korean importers to finance certain consumable commodities, such as synthetic yarns, chemicals, and pulp, but had not been taken up by the importers. The agency reported that at January 31, 1962, approximately \$12.2 million and \$1.1 million of the above funds obligated in 1961 and 1960, respectively, were still available to Korean importers.

According to ICA the lack of demand for these funds on the part of the Korean economy was due to the following factors:

1. Political uncertainty resulting from the change of government including special investigation by the Revolutionary Government of businessmen accused of illegal profiteering.
2. Increase in the official hwan-dollar exchange rate which had raised the prices of imported commodities for which the bidding rates had been below the revised rate of 1300-1.
3. The increased import costs due to the President's balance of payments directive of November 1960, curtailing procurement in specified countries and emphasizing procurement from United States sources.

While ICA funds were unused or being used for low priority consumer imports, ICA was reluctant to make funds available for other activities in the public sector which were more essential to Korean economic development and which were delayed or were not being undertaken. Although the power shortage has been recognized as one of Korea's most critical problems, a proposed power plant at Pusan to be constructed by the International General Electric Company was delayed because the Korean Government was not able to set aside all the funds needed to finance this plant. At the same time, ICA funds sufficient to finance this plant were made available for the importation of rayon and nylon yarns and other consumable goods. Also a shortage of railroad cars had been adversely affecting the economic progress of Korea and, although ICA recognized the need for additional railroad rolling stock by the Korean National Railroad, aid funds sufficient for this type of capital investment were not made available.

#### Reduced control over commodity composition

In past years, ICA exercised control over the commodity import program through the issuance of procurement authorizations (PA) which specified the amount and type of commodity authorized

for import by Korea with aid funds. In fiscal year 1961, a "multicode" PA in the amount of \$40 million was issued which included nine different commodity classifications<sup>1</sup> and which permitted Korean industry to purchase commodities in any one of the different commodity classifications included therein in the quantities that it, rather than ICA, determined were necessary. Under the multicode PA there were no amounts specified as the minimum or maximum for any commodity classification and the types and amounts of commodities to be imported were left largely to market forces as evidenced in applications by Korean business for import foreign exchange. Thus Korean business was in a position to purchase any amount of any eligible commodity irrespective of its benefit to the Korean economy. Mission industrial technicians advised against adopting this new policy on the ground that it would work against the best interests of the Korean economy. Korean business will usually buy those commodities which yield the greatest profit, and such commodities may not be those essential or even beneficial to Korean economic growth.

Of the commodities eligible under the multicode procurement authorization, those for which the demand was strongest were the commodities used to produce consumer goods, such as pulp, chemical preparations, and rayon yarn. At the conclusion of our field review the most popular ICA commodity under the multicode PA was pulp, which is used chiefly to produce newsprint and paper.

The Korean business community has not shown any notable concern for the economic welfare of Korea in the past and on occasion has not abided by agreements with ICA. For example, each year ICA financed imports of substantial quantities of phosphatic fertilizers which are considered essential for Korean agriculture. Since this type of fertilizer has not traditionally been popular with Korean farmers, fertilizer importers earn lower profit on its sale than on the sale of ICA-financed nitrogenous fertilizer. In past years, when making United States aid funds available for commercial procurement of fertilizer, ICA required Korean importers to procure a specific amount of phosphates along with nitrogenous fertilizers. In 1961 ICA released the importers from the phosphate purchase requirement because they agreed to purchase phosphate voluntarily. However, of \$4,040,000 made available as of June 30, 1961, for commercial procurement of phosphate fertilizers, only \$10,000 was used while at the same time ICA funds for nitrogenous

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<sup>1</sup>A commodity classification may include a large number of different though related individual commodities; for example, the textile products classification might include rayon or nylon yarn, cloth, or other finished textile goods.

fertilizers were substantially oversubscribed. According to the records at the Mission, members of the Korean Traders Association, at a meeting in July 1960 to discuss the fertilizer program, informed Mission personnel that their duty was only to sell those items which would give them the most profit. Since May 1961, all imported fertilizer has been procured by the government.

We seriously question whether the policy of permitting market forces to determine the types and quantities of commodities to be imported is compatible with the accepted premise of Korean economic underdevelopment and the present status of Korean economic and political maturity. It is our view that, until such time as Korea gets much further along the road to economic self-sufficiency, commodity imports should be controlled so as to assure that foreign exchange, from both Korean and outside aid, is devoted in appropriate measure to capital goods which will further economic progress.

The adoption of the multicode PA also had the effect in 1961 of avoiding loss of the authority to deobligate and reobligate funds which the Congress had terminated by omitting such authority from the 1961 Mutual Security Appropriation Act. This authority had been included in prior years' appropriation acts, and ICA had made extensive use of the authority to transfer funds from one activity to another. Fiscal year 1961 funds deobligated after the close of the fiscal year could not be reused and reverted to the United States Treasury.

The multicode PA plan (which makes a number of commodities eligible for financing on one document) adopted by ICA permitted the shifting of financing from one commodity to another without the necessity for deobligation. In requesting ICA approval of the new multicode plan, the Mission asked that the shifting of funds between the various commodities included in the multicode PA be interpreted liberally so as to avoid application of the deobligation and reobligation procedures for which legislative authority had been discontinued.

The authority to deobligate and reobligate funds was reinstated in the foreign assistance appropriation act for 1962.

### Conclusion

The program presentation to the Congress for fiscal year 1962 continued the emphasis on consumable goods, in lieu of investment goods, for financing as "supporting assistance." While it is the expressed policy of the administration to finance economic development through development loans, we believe it should be feasible and would be desirable to include capital goods in the supporting assistance program to the maximum extent practical and shift as

much as possible of appropriate consumables for import with Korean foreign exchange. We believe that, for a country such as Korea facing the need for extensive economic development, the use of aid funds for capital purposes tends to encourage greater financial responsibility by the recipient country in the use of its foreign exchange and gives a stamp of visible and lasting benefit to the aid program.

#### Proposed action and agency response

In consideration of the matters discussed above, we proposed to ICA that:

1. It should reach agreement with the Korean Government on a system of priorities for the allocation of both Korean foreign exchange and aid funds designated for commodity imports, so that, over and beyond the financing required for the minimum quantities of essential consumable goods, priority would be given to capital goods in the order of their considered importance to economic advancement.
2. As an integral part of the system of priorities proposed in (1) above, ICA should reconsider its policy in respect to the multicode procurement authorization from the standpoint of the need in Korea for commodity import control through more specific commodity limitation in procurement authorizations.

The agency expressed concurrence with the proposal that emphasis be placed on financing capital goods to the extent practicable and that the use of Korean foreign exchange be encouraged in every way possible for consumable goods and stated that such principles are in conformity with current development fund concepts of AID. The agency further reported that a comprehensive review was being made of its procurement policies and procedures (including the use of multicode PA's), to revise its methods and operations to current program concepts and objectives.

## COLLUSIVE BIDDING FOR ICA FUNDS

For a number of years aid funds made available for financing commodity imports were allocated to Korean importers through several systems of auction bidding. (See p. 57.) In the several years before the exchange rate reform in February 1961, local currency, in amounts not known but acknowledged to be considerable, was lost to the Korean Government through collusive bidding by Korean private industry. The effects of this collusion lessened the resources of Korea for meeting its economic and defense needs and thus increased the pressures for higher dollar aid, enabled the collusive bidders to realize windfall profits, and encouraged loose ethical standards of Korean business practices.

Under the system in effect between 1958 and the date of the exchange rate reform in February 1961, bids consisted of (1) the hwan equivalent of the dollars applied for computed at the official rate of exchange (which was considerably less than the market rate) and (2) a foreign exchange tax at a minimum of 150 hwan per dollar. Award was made on the highest bid on the foreign exchange tax, which ranged from the minimum of 150 hwan per dollar to as high as 800 hwan per dollar. The extent of competition generally determined the amount of the tax, the more competition the higher the tax. The degree of competition depended on the type of commodity for which ICA funds were being auctioned, the amount of such funds, and the number of eligible bidders.

Bidding was restricted by allowing only direct end-users (manufacturers or processors) to purchase certain ICA funds. Korean traders were excluded to prevent speculation and profiteering in these commodities and to insure a source of raw materials for Korean industry. However, this restricted bidding also made it possible for the eligible bidders to conspire to secure ICA funds at the minimum bid price which was considerably less than the market rate of exchange. For example, during calendar year 1960 the official rate of exchange was 650 hwan to 1 dollar so that minimum bids (official rate plus minimum foreign exchange tax) were 800 hwan. During this time the market exchange rate was about 1,200 hwan to 1 dollar. The eligible bidders agreed among themselves for each to bid for a stated amount of dollars at the minimum bid price, the total amount of all bids being equal to the total ICA funds being auctioned.

In an effort to persuade the Korean Government to ease its restrictions on bidder eligibility, ICA in 1956 made available an additional \$25 million in aid in return for which the Korean Government agreed to (1) ease the specified end-user system by broadening bidder eligibility and (2) adopt all feasible measures to maximize internal hwan revenues.



Although subsequently there was an easing of the specified bidder system, restrictions on bidder eligibility continued for certain commodities, notably cotton. In December 1960 ICA made representations to the Korean Government to end the specified bidder system because of its discriminatory aspects against nonmembers of selected industrial groups and its restriction of free competition; however, the degree to which restrictions would be lifted was left to the discretion of the Korean Government.

### Cotton

Bidding for ICA cotton funds was probably the most flagrant example of collusive bidding in the commodity import program. Under the rules drawn up by the Korean Government and agreed to by ICA, only members of the Spinners and Weavers of Korea (SWAK) were eligible to bid. As a consequence, SWAK's control was so complete that other end-users were unable to obtain cotton needed in their operations even though, in at least one case, the end-user's machinery had been financed by ICA under the project assistance program. Some of the plants of these end-users were shut down for periods up to 9 months because they had no cotton.

In 1957, under a new policy promulgated by the Combined Economic Board, restriction of eligibility solely to specified end-users to bid for aid funds was no longer permitted. The new policy earmarked a portion of aid funds for bidding open to all applicants. However, for a few commodities, such as cotton and wheat, restriction of bidder eligibility was continued.

Bids tendered by SWAK members were always at the minimum bid price. In addition, the dollar value of the bids generally exactly equaled the dollar value of the ICA funds being offered, which indicated that the bids resulted from prebidding consultations among SWAK members. We reviewed the results of 20 auctions of cotton dollars held between November 1957 and December 1960. Of 186 bids offered, 184 were identical, and in most cases the dollar value of the bids totaled almost exactly the same as the funds auctioned and therefore there were no unsuccessful bidders. After the fall of the Rhee government, the new Korean Government wanted to make cotton bid auctions competitive, however, ICA refused to end the close control by SWAK (except to allow small end-user associations whose plants were idle to buy ICA-financed cotton) because it believed that only SWAK was competent to purchase cotton from United States suppliers. ICA refusal to permit open cotton auctions is hard to understand since it had previously urged the Korean Government to allow open auctions.

ICA recognized that significant hwan revenues were lost because of the low level of foreign exchange tax bids for cotton funds. In an effort to increase such revenues, the minimum foreign exchange tax for cotton was increased in fiscal year 1961.

from the 150 hwan minimum tax, applicable to all commodities, to 270 hwan per dollar and again to 310 hwan per dollar. We estimate that, if this added tax had been in effect during fiscal year 1960, hwan revenues from the sale of cotton dollars in that year would have been increased by the equivalent of about \$7.4 million. ICA agreed that this loss of revenue represented "windfall profits" to SWAK members.

### Rayon yarn

In 1957, in accordance with the new CEB policy permitting open bidding for specified portions of ICA aid funds (see above), a part of the ICA funds designated for rayon yarn financing was made available for auction to both end-users and traders, with the balance set aside solely for end-users. Recognizing that collusion was practiced when bidder eligibility was restricted, with a resulting loss of hwan revenues, ICA favored increasing that portion of aid funds earmarked for open bidding; for calendar year 1960, 35 percent of rayon funds was allocated for open bidding and 65 percent was restricted to specified end-users, and the Korean Government proposed the same rate for 1961. However, the matter of apportioning funds became academic because of the abolishment of the auction system in April 1961, after the adoption of a unitary exchange rate, and the availability of foreign exchange to all applicants due to a slowdown in Korean business activity. (See pp. 103 and 104.)

Our review of bids made at both open and restricted rayon fund auctions showed that the bids at the open auctions were usually higher than the bids at auctions at which bidder eligibility was restricted. Furthermore, the total of the bids at the restricted auctions almost exactly equalled the amount of funds auctioned and there were no unsuccessful bidders, while at the open auctions the aggregate bids generally exceeded the funds auctioned and there were some unsuccessful bidders.

In the case of rayon yarn, complications arose as the result of opening auctions to other than end-users. Traders who imported rayon with funds obtained at open auctions hoarded their stocks to create artificial shortages and sold at resulting high prices; the domestic price of rayon rose over 80 percent between January and August 1959. Certain measures were adopted to restrict this practice, such as requiring traders to dispose of their stocks within a specified period or lose further eligibility to bid. However, the need to maximize hwan revenues was considered of sufficient importance to continue the trader eligibility to bid, irrespective of their undesirable actions.

### Conclusion

There seems to be no question that in the aggregate the Korean Government was deprived of very substantial revenues because

of collusive bidding and that economic progress in Korea was significantly slowed down to the detriment of the aid program. This matter of collusion is part of the general corruption picture in Korea which is the subject of separate discussion in this report, but we are dealing with it here because of its specific character and identification with the commodity import program.

DEFECTS IN FINANCING OF  
INDUSTRIAL ENTERPRISES AS NONPROJECT AID

ICA financed as nonproject assistance under the commodity import program, the establishment and major expansion of industrial enterprises similar in basic characteristics to projects financed under the project assistance program. This type of financing has had two fundamental defects:

1. The absence of any system of priorities in approving individual enterprises and in allocating aid funds contributed to unbalanced industrial expansion, as reflected by the overexpansion of some industries and the failure of other essential industries to receive needed assistance.
2. The annual program presentation to the Congress did not show that nonproject funds were being used to finance the establishment and expansion of industrial enterprises as single-package activities (projects) basically the same as projects under the project assistance program.

Absence of priorities  
contributed to unbalanced expansion

Individuals or groups desiring to establish a new industry or expand or modernize an existing facility and requiring no technical or financial assistance other than foreign exchange for the import of equipment, filed applications for approval of the enterprise by the Saleables Review Committee (SRC) of the CEB. Review by SRC was designed to eliminate from eligibility for ICA financing such commodities as would (1) result in overinvestment, (2) compete with ICA-financed projects, (3) duplicate machinery already idle in Korea, (4) not be suitable to the present industrial level, and (5) displace items made or which could be made in Korea. We understand that the SRC review also covered the over-all aspects of the proposed enterprise in the same manner and scope as the review of proposed projects under the project assistance program.

Approval by SRC did not assure the foreign exchange but merely made the applicant eligible to bid at an auction of ICA funds for industrial machinery. Thus the applicant had to compete with other approved applicants for equipment for other types or the same type of industry. ICA funds were auctioned by individual procurement authorization, and generally all industrial machinery was covered in one authorization under the same commodity classification of industrial machinery. Since SRC approved applications aggregating in amount considerably more than the aid funds being auctioned and did not have any priority system as to approved

applications, only the highest bidders received an allocation of ICA funds. Total bids greatly exceeded the funds auctioned for financing of industrial equipment. For example, in 1958 bids totaling nearly \$35 million were made for \$8.5 million of aid funds. Thus obtaining foreign exchange for these enterprises became more a matter of the financial resources of the applicant and his willingness to bid high enough rather than the relative essentiality of the enterprise to the economic benefit of the country. Large numbers of applicants did not obtain aid funds because they did not or could not bid high enough. During the first 8 months of 1959, only 101 of 174 bidders for industrial machinery were successful.

The manner in which this type of financing was administered contributed to unbalanced and costly economic development. The textile industry which is the largest in Korea was rebuilt and expanded largely with ICA nonproject funds. Mission technicians reported that, as a result of this aid, they considered the textile industry overexpanded, principally in the cotton area, and consequently during 1960 ICA withheld approval of applications for textile machinery financing. In a March 1960 auction the successful bidders included a number of textile companies which proposed to import additional or replacement spinning equipment while among the unsuccessful bidders were two companies which proposed to import machinery for manufacturing fishing nets. As pointed out above the textile industry was considered overexpanded, and it had been established that Korean production of fishing nets was insufficient to meet Korean requirements. The Korean sugar-refining and flour-milling industries which also received extensive financing from nonproject funds to import machinery were considered by ICA as overexpanded.

The view expressed by ICA was that, if potential investors were unwilling or unable to bid high enough to obtain foreign exchange, it was unlikely that their enterprises could operate successfully. We believe that as a generalization in the framework of the aid program this view is unsound. Some industries or companies are better financed than others but may not be as essential. Moreover we note that, with respect to industries financed as projects under the project assistance program, in many cases Korean sponsors lacked sufficient capital even for operation but aid was given on the overriding proposition that the enterprise was considered important to Korean economic advancement. A mission report dated July 1958 called attention to overexpansion and wasted funds in idle machinery resulting from the lack of any systematic program for allocating nonproject aid funds earmarked for machinery.

After the adoption of the unitary rate of exchange in February 1961, the auction of aid funds was discontinued. At the completion of our field work, business activity was slow principally

as an effect of the exchange rate adjustment, aid funds were available, and foreign exchange was being allocated to all applicants. However, this condition was obviously temporary since continuance of the commodity import program stems in large part from the insufficiency of Korean resources to satisfy total import requirements. Thus it may be expected that in due course applications for foreign exchange will exceed the total available, including aid funds, and the danger if not likelihood of industrial over and under development will continue unless effective measures are instituted to assure that available foreign exchange is allocated to those industrial sectors of highest need to economic development.

#### Conclusion and recommendation

We believe that the remedy for the situation described above lies in establishing priorities in the allocation of aid funds, and also Korean foreign exchange, to approved enterprises and integrating such priorities into the system of priorities recommended with respect to capital and consumable goods (see p. 97). Accordingly, we recommend such action.

#### Inadequate disclosure to the Congress

The annual program presentation to the Congress has classified aid under two main categories--project and nonproject. Project aid has generally been considered to involve integrated undertakings designed to accomplish specific tasks. A list of major projects, in being and proposed, has been submitted to the responsible congressional committees along with the program presentation. For nonproject aid, the presentation shows a breakdown by about 5 to 8 broad types of commodities including a delineation of capital and consumable commodities and accompanied by a narrative as to the purpose and necessity of the proposed aid. What is not brought out in the presentation, however, is that some nonproject funds have been used to finance new or existing enterprises under substantially the same conditions as exist in the financing of projects, also in some cases the nonproject funds were for the same enterprise that was receiving project assistance funds as a project. For example, for one project in the industry program, ICA approved the use of \$250,000 of project funds for the purchase of textile dyeing and finishing equipment while, under the nonproject program, ICA funds in the amount of \$144,000 were approved for the procurement of additional industrial machinery by the same company for the same enterprise. In another instance, project funds in the amount of \$110,000 were provided for the purchase of flour mill conveying equipment while \$270,000 in nonproject funds was used by the same flour mill for flour mill processing equipment. In still another case, ICA project funds in the amount of \$470,000 were used primarily for the purchase of textile-processing equipment by a plant, subsequently, the same company was approved by ICA for \$800,000 in nonproject funds for additional textile-processing equipment.

ICA has not maintained its records in such a way as to make it practicable to determine how much of the total nonproject funds were used for financing enterprises as distinguished from individual pieces of equipment for various industrial plants. It is worthy of note that nonproject funds proposed for industrial machinery and vehicles in the program presentation for fiscal year 1961 amounted to \$24.6 million while the total proposed for the entire project assistance program amounted to \$15 million.

We observed in our audit that ICA made basically the same technical and financial review of package enterprises financed from nonproject funds as it did of projects under the project assistance program. Further, the same statement issued by ICA for internal management control purposes, certifying as to compliance with section 517 of the Mutual Security Act of 1954, on projects under the project assistance program, was also issued as to enterprises financed from nonproject funds. Section 517 provided that funds could not be obligated for any activity that was estimated to cost in excess of \$100,000 and that required substantive technical or financial planning before such planning and firm cost estimates were developed.

ICA claims that the enterprises financed from nonproject funds differ from projects in that the former require no government financing and no technical assistance whereas in the case of projects the sponsors generally have to obtain loans from the counterpart fund for investment capital and sometimes for operating funds and the sponsors need technical assistance in planning, constructing, and operating the project. We believe that these differences are more procedural than substantive and that in all basic respects the enterprises financed from nonproject funds are the same as projects financed under the project assistance program.

The principal defects in the nonproject financing of the entire-package enterprises are that the program breakdown between project and nonproject aid as shown in the annual program presentation to the Congress is inaccurate, that the amounts of aid shown for individual projects in the listing of major projects are also inaccurate for those projects which have received nonproject funds; and that, by reason of these inaccuracies and the lack of clear disclosure about this type of financing, the presentation is misleading and the responsible congressional committees are at a disadvantage in their analysis and judgments on proposed aid programs.

The agency advised in March 1962 that this situation will ultimately resolve itself since (1) the commodity assistance component of the project program is being reduced as a result of a review of the program during 1962, (2) there has been a significant revision of investment financing tending toward a reduced proliferation of projects, and (3) new legislation provides that major

★ projects be funded by loans requiring different accounting and reporting requirements. These considerations relate primarily to financing under the project assistance program and would still permit nonproject financing of single-package enterprises from certain funds authorized under The Foreign Assistance Act of 1961.

#### Recommendation

We recommend that, insofar as the financing of entire-package enterprises under the commodity import program, such as described above, may be continued, the agency develop some effective means of overcoming the defects in the program presentation as cited herein. We further recommend that the agency discontinue the practice of large-scale financing of the same industrial plants from two sources--nonproject and project funds--as this practice tends toward confusion in project cost recording and inaccurate project reporting.



## DEFICIENCIES IN FERTILIZER PROGRAM

Fertilizer has been the principal commodity import financed by ICA. Total ICA financing aggregated \$119.5 million for the period 1954-56 and \$235.7 million from 1957 through 1961. The program has been more costly and less beneficial to the Korean agricultural sector than it should have been principally because of the following conditions:

1. From 1959 through 1960 the program did not have the benefit of necessary technical guidance by the Mission.
2. ICA did not participate in the determination by the Korean Government as to the quantities and types of fertilizer to be imported or as to the use of fertilizer within the agricultural sector.
3. Procurement costs were higher than necessary because of (a) failure to purchase in off season and (b) the allocation of increased purchasing of fertilizer to Korean private business which paid a higher price for fertilizer than the Korean Government had paid.
4. Delay in utilizing fertilizer produced by the ICA-financed Chung-ju fertilizer plant resulted in loss to the farmers of a substantial quantity of fertilizer for at least one farming season.

### Lack of technical guidance by mission

Although ICA-financed fertilizer imports averaged in excess of \$40 million annually, the Mission did not have a fertilizer technician from 1959 through 1960. The functions of such a technician in the Korea program included (1) advice on the types of fertilizer to procure, crop allocations, and fertilizer handling and distribution and (2) instruction to Korean farmers as to the benefits and use of various types of fertilizer (potash and phosphate) not traditionally used by them. These functions require extensive contact with farmers throughout the country as well as work at the Mission and the Korean Ministry of Agriculture. In view of the magnitude of the fertilizer activity and its significance in the Korean economic structure, these technical services were important if not essential to the achievement of the agricultural objectives of the aid program.

ICA assigned a fertilizer adviser to its Mission in 1956. Prior to that time the Korean fertilizer program had been the subject of congressional criticism for faulty procurement practices.

ICA reported that, through the work of the advisor, substantial savings in procurement costs were realized and procedures

were devised for a balanced fertilizer import program. Also extensive black market operations were reportedly curbed. Upon departure of the advisor in July 1959 and contrary to his recommendation, ICA allowed the position to lapse and undertook to administer the program by committee without the benefit of a full-time technical advisor. Thereafter the committees and subcommittees which attempted to handle all individual problems grew so numerous that late in 1959 the existing system was abolished and a new over-all committee was established. This committee's first decision was that the program could not be administered by the committee method and that a technical advisor was necessary. Subsequently, in October 1960, a fertilizer advisor was assigned to the Mission. At the time of our field review, the Mission fertilizer staff consisted of one American technician and a Korean assistant.

Although its effect is not measurable, we believe that the lack of a fertilizer technician hindered the program significantly and also contributed to the conditions described in the following pages.

The agency claimed that, despite the absence of a fertilizer technician, effective work, such as field demonstrations on the use of unpopular fertilizers, had been carried on under the supervision of Mission agricultural advisers and that this work was used as a guide in determining the levels and kinds of fertilizer which now make up the Korean fertilizer program

#### Recommendation

We recommend that, if the program continues at a level approaching that of past years, consideration be given to increasing the strength of the fertilizer advisory staff with the objective of further improving the administration of this important program.

#### ICA excluded from basic fertilizer decisions

Beyond determining the amount of annual funding, ICA had little voice in determining the manner in which fertilizer would be used. The Mission did not have free access to agronomic and economic data used by the Korean Ministry of Agriculture to determine Korean fertilizer requirements and expressed its doubts as to the basis for the Ministry's decisions.

ICA was not consulted nor was its advice heeded by the Korean Government on matters such as the quantities of the various types of fertilizer to be imported and the purpose for which fertilizer was to be used. For example, the Korean Government did not allocate ICA-financed fertilizer to the Korean soybean crop in the past and, as a consequence, the low yield of soybeans required the United States to finance substantial soybean imports for use of the Korean Army and civilian populace. (See p. 72.)

The Mission's chief agricultural technologist reported that biological evidence indicated wasteful use of United States aid funds because of Korean insistence on purchasing too high a proportion of nitrogenous fertilizer. A fertilizer consulting team employed by ICA in 1956 reported that there were insufficient data available in Korea on which to make basic determinations regarding Korean fertilizer requirements.

Despite large annual commitments for the purchase of phosphatic and potassic fertilizers, the Mission had difficulty in obtaining data showing the value of these fertilizers to Korean agriculture. ICA records showed that as late as 1960, 7 years after inception of the aid program, the Mission did not know Korea's yearly fertilizer requirements; economic factors affecting fertilizer use; major crop requirements; or actual crop allocations including crop class, acreage, and time of allocation.

In May 1960, the Mission prevailed on the Korean Ministry of Agriculture to permit an American technical advisor to have access to the Ministry's agricultural data on the ground that ICA was providing "financing \*\*\* of fertilizer goods for a program about which it actually knows very little." When the American advisor reported to the Ministry, Korean officials were reluctant to furnish him with all data requested, but from the limited data furnished he reported that the fertilizer program as conducted in the past was unsound on an agronomic basis and needed drastic revision. At the conclusion of our field audit (June 1961), the Mission's fertilizer advisor was working on a full-time basis at the Korean Ministry.

#### Fertilizer procurement costs higher than necessary

ICA paid higher prices for fertilizer than were necessary because of (1) the failure to take advantage of off-season prices even though the compensating benefits of timely deliveries were not realized and (2) insistence on the use of the less economical commercial procurement channels.

#### Failure to take advantage of off-season prices

World market prices for fertilizer are governed in part by the date of delivery; if delivery is scheduled during the period of greatest demand, prices are higher than if delivery is scheduled before or after the peak fertilizer application periods. For fertilizer procured from the United States, higher prices are paid if delivery is requested between February and July, while, for fertilizer procured from Japan, prices are higher if delivery is scheduled between April through July. The price of nitrogenous fertilizer delivered during the off season is generally about 20 percent lower than the price charged for delivery during the demand season. For phosphatic fertilizer, the saving is about

10 percent. In Korea the peak fertilizer demand periods are between April and June for basic applications of fertilizer to the rice crop and September to October for application to the barley crop. ICA fertilizer was usually ordered for delivery during the demand season, yet because of delays in delivery and in moving the fertilizer from Korean ports to the farming areas, the fertilizer was not available to the farmers when needed. Consequently the intended benefit of the higher price was not obtained and the fertilizer might well have been purchased for off-season delivery and a corresponding dollar saving realized.

Although untimely fertilizer deliveries had been a problem in the Korean program for a long time, it was not until the end of fiscal year 1961 that steps were taken to program ICA fertilizer procurement well in advance of need in order to assure timely deliveries. ICA informed us that in the past it had been unable to program in this manner because neither ICA funds nor Korean-owned foreign exchange was available in sufficient amounts. However, our review indicated that the increased Korean foreign exchange reserves (see p. 70) would have financed substantial advance procurement.

#### Higher costs of Korean commercial procurement

Fertilizer financed by ICA was procured primarily by Korean Government agencies and Korean business firms. ICA policy had been to channel an increasing percentage of fertilizer procurement through Korean business firms, although it recognized that fertilizer procured by these firms was more costly than fertilizer procured by the Korean Government and despite advice of the Mission's supply advisers that the Korean commercial community was not sufficiently responsible to participate in the fertilizer program.

Until fiscal year 1956, fertilizer was procured by Korean and United States Government agencies. In that year, in partial consideration for additional aid to Korea, a portion of aid funds was set aside for commercial procurement of fertilizer. ICA continued to advocate fuller use of commercial procurement channels, and the percentage so allocated increased until shortly after May 1961 when the new Korean Government insisted on 100-percent government procurement.

ICA records show that fertilizer procured through commercial channels was more costly to ICA than fertilizer procured by Korean Government agencies. A Mission analysis of urea fertilizer purchases under the fiscal year 1959 fertilizer program showed that commercial procurement costs were nearly \$8 a ton higher than the cost of government-procured fertilizer, primarily because the government purchased in larger quantities than did the commercial fertilizer dealers. The 1959 program included 26,300 metric tons of commercially procured urea. The dollar cost of this urea was

approximately \$200,000 higher than comparable cost of government-procured urea.

Korean dealers have not been reliable or trustworthy in their dealings in aid-financed fertilizer. An ICA audit of commercially procured and distributed fertilizer disclosed that the dealers did not maintain records showing the actual utilization and distribution of imported fertilizer valued at \$6 million. Also the dealers did not live up to an understanding with ICA for fiscal year 1961 that they would import a specified quantity of phosphate fertilizer needed by Korean farmers but on which the dealers earned smaller profits than on the more popular nitrogenous fertilizers. Of \$4,040,000 authorized for commercial importation of phosphates, at June 30, 1961, only \$10,000 had been used, and the balance was reprogramed for procurement of fertilizer during fiscal year 1962.

Regarding procurement by Korean commercial dealers, the Mission's Office of Supply Management (SM) made the following statement:

"We, of course, support the ICA policy of maximum emphasis on placing procurement in normal channels of trade. However, experience with previous fertilizer programs handled by the commercial community has caused SM to conclude that the commercial community is not quite ready to fully meet this responsibility. This conclusion is based on the fact that prices paid under our commercial procurement program for fertilizer were excessive and, of more importance, there was throughout Korea maldistribution of fertilizer.

"Therefore, SM believes that the commercial community should not be permitted to participate in the FY 1961 fertilizer program to the degree it has in the past unless action is taken that would eliminate or substantially minimize these deficiencies."

ICA informed us that, because of the new Korean military government's insistence on 100-percent Government procurement, there no longer was a problem of overcoming the disadvantages of high prices paid by the commercial sector.

#### Delay in utilizing production of Chung-ju fertilizer plant

Because of its high price, the production of the ICA-financed Chung-ju fertilizer plant was not utilized for an extended period. This delay was harmful to the Korean farmers and the financial operations of the plant.

The Chung-ju fertilizer plant was one of the largest ICA-financed projects in Korea, and its production was expected to

provide approximately one fourth of Korea's fertilizer requirements. The plant was completed in late 1960, and management was assumed by an agency of the Korean Government, operating with the advice and assistance of an American contractor. Fertilizer produced by the plant through May 1961 was as follows:

| <u>Calendar year</u> | <u>Metric tons</u> |
|----------------------|--------------------|
| 1960                 | 13,344             |
| 1961 (through May)   | <u>25,709</u>      |
| Total                | <u>39,053</u>      |

Of this production, only 14,421 metric tons had been sold by May 31, 1961, principally because its price, which was fixed to cover all costs of production plus a 10-percent profit, was higher than the fertilizer dealers and trade associations were willing to bid at the several auctions at which the Chung-ju product was offered.

Subsequent to our field examination, ICA informed us that the Chung-ju inventory was being turned over to the Korean National Agricultural Cooperatives Federation, an association of village cooperatives, at a price corresponding to that of fertilizer imported under the commodity import program.

The delay in adopting a plan which would permit the use of the Chung-ju production was responsible for the loss to the Korean farmers of a substantial quantity of badly needed fertilizer for at least one planting season. Furthermore, the failure to sell the production, and thus earn revenues, necessitated release of counterpart funds to enable the plant to continue its operations.

The agency informed us in March 1962 that the Korean Government had been advised that (1) sales of domestically produced fertilizer to farmers should be at the same price as imported fertilizers, or lower if possible, and (2) domestically produced fertilizers should be included in the basic government fertilizer ration for rice, barley, and soybeans to insure full utilization of the domestic production

## AID PROGRAM ENCOURAGED NEW LUXURY WANTS AND UNECONOMICAL IMPORTING

Despite Korea's extreme trade imbalance and the low standard of living of most of the Korean people, United States aid funds financed imports of luxury or semiluxury materials such as top quality wool and nylon yarns which were used to produce wearing apparel. Before the aid program the Korean population dressed in clothing made predominantly from cotton and silk, both of which were produced locally. Thus consumption habits beyond the standard possible to be maintained at present by the country's economic resources were encouraged, aid funds were not utilized to the best advantage of the Korean economy; and local industries, particularly cotton, were adversely affected. ICA technical personnel reported that it was unwise to continue financing these materials because of their very high quality, relative cost, and luxurious nature. The agency attributed the use of such aid funds to the pressure of Western influences and the demands of an industrializing economy.

The aid program also financed the import of pulp without taking advantage of economies that could be realized through the use of wastepaper in mix with chemical pulp in the manufacture of certain kinds of paper.

### Wool

The aid program financed the import of about \$20 million worth of wool tops--a wool product from which worsted cloth for men's and women's clothing is made--and also the import of substantial machinery for Korean firms to produce worsted cloth from wool tops. Wool tops were among the principal commodities imported with Korean foreign exchange; Korean wool top imports totaled \$5.8 million and \$2.3 million in 1959 and 1960, respectively. In order to reduce the cost to Korea of wool tops, ICA agreed in 1960 to provide \$1.5 million to purchase machinery which would produce wool tops from less costly raw wool.

ICA recognized on a number of occasions that wool tops were not the type of commodity which should be financed with United States aid funds. The agency planned to reduce its financing of wool tops in 1959 and eliminate it entirely in 1960 but did not do so at the insistence of the Korean Government.

In addition the wool tops purchased were of a higher quality than the average used for worsted cloth production in the United States and in New Zealand which is a major wool producer. The Mission's textile advisor reported that it was a mistake to finance for domestic Korean use the highest quality wool tops for processing worsted fabrics.

Early in fiscal year 1958, the ICA Washington office expressed to the Mission its concern about the high quality of wool tops being financed, pointed out that aid funds should be used for grades of wool tops more nearly in proportion to those used by the rest of the world, and suggested that Korean foreign exchange be used for the purchase of the luxury grades. Although ICA imposed restrictions on the higher quality grades, the quality of wool tops financed with aid funds continued to be higher than the average quality used in the United States. For example, the wool tops financed in 1958 under the aid program were as high as 64-count quality; in fiscal years 1959 and 1960 as much as 50 percent of ICA wool top procurement funds were authorized to purchase 62-count tops. ICA records indicate that the best worsteds for durability, low maintenance, and medium price are manufactured from tops of 48-60 count.

The agency advised that action had been taken to limit the 64-count quality but lack of technical ability on the part of the Korean spinning mill technicians made it inadvisable to go further in lowering the grades of wool tops, that cloth made from lower grade wools and wool tops requires more technical know-how, and that only recently had the industry demonstrated its capacity to finish fabrics utilizing the lower grades of wool. The agency also pointed out that the prices of the higher count wool tops from Australia, where most wool tops for Korea were procured, were more favorable than the prices of lower count tops from the United States and therefore no savings in foreign exchange would have been realized from purchases of the lower count wool tops and further that Australia did not offer lower count tops for export.

#### Nylon yarns

Nylon yarn imports into Korea have been used largely to produce 100-percent-nylon stretch socks and other wearing apparel. Before the aid program, no nylon yarn was imported into Korea and men's socks were produced from cotton and other cheaper fabrics. Through 1958, aid funds and Korean foreign exchange had been used to import \$9.3 million worth of nylon yarn. In 1958 ICA limited its funding of nylon to \$500,000 and for 1959 and 1960 designated nylon as ineligible for aid financing for the following reasons:

1. Korean use of 100 percent nylon in sock manufacture was considered a waste of foreign exchange.
2. Nylon was very expensive, costing from \$1 to \$5 a pound whereas rayon, which could be used as a substitute, costs only about 50 cents a pound.
3. The sale of nylon socks hurt the market of the cotton producers whose imports were also being financed by ICA.



4. The reduction in aid funds necessitated economies in the ICA program.

However, the demand created for nylon was such that increasing amounts of Korean foreign exchange were used to purchase this commodity--\$4.9 million in 1959 and \$6.1 million in 1960. Nylon was a high-profit item which was very popular with the Korean business community.

In recognition of the drain on foreign exchange from the importation of nylon yarn and the fact that Korean demand for nylon yarn had become an established element of the economy, ICA approved the use of \$496,000 for the importation of machinery to produce, in Korea, nylon filament yarn from less expensive raw materials. ICA also approved applications for financing nylon-processing machinery after pressure was reportedly exerted by the Korean Government to secure this machinery. The Development Loan Fund also approved a loan in the amount of \$3.2 million to establish a nylon filament plant.

In 1961 the restriction against nylon imports applied in 1959 and 1960 was dropped and ICA financed \$6.2 million worth of nylon yarn imports. Although ICA industry advisors had opposed this financing it was approved on the ground that, since substantial amounts of Korean foreign exchange were being used to purchase nylon, it was useless to try to exclude nylon from the country.

The agency stated that it had never advocated large imports of nylon and that it had recommended to the Korean Government that nylon be used as reenforcing material in the production of cotton socks rather than in the production of 100-percent-nylon socks. The agency also pointed out that imported nylon and domestically produced nylon yarn were used in production of tires and fish nets.

#### Uneconomical use of pulp in paper manufacture

ICA financed practically all of Korea's chemical pulp imports, a large part of which were used in the manufacture of paper and paper products other than newsprint. Due consideration does not appear to have been given prior to 1960 to the economies which could be realized through the use of wastepaper in the manufacture of paper and paper products other than newsprint; we understand that wastepaper cannot be used in the manufacture of newsprint. The cost of imported wastepaper is about \$70 a ton, compared with chemical pulp costs of \$140 a ton. According to ICA technical data, finished paper may consist of from 10 to 20 percent wastepaper. ICA estimated annual savings in excess of \$250,000 in foreign exchange costs through the substitution of imported wastepaper for a portion of chemical pulp imports. These savings would be increased to the extent that locally available wastepaper was used.

Despite these potential economies, the principal paper manufacturers in Korea did not use imported wastepaper or all available domestic wastepaper in their operations, although according to ICA the quality of the paper produced would not have been adversely affected. The reasons given was that they lacked de-inking facilities necessary to process wastepaper into suitable form for manufacture of bond paper and that Korea's wastepaper was of poor quality and too expensive. ICA informed us that some domestic wastepaper is used in the manufacture of certain paper products.

In 1960 ICA pointed out to the Korean Ministry of Reconstruction the substantial savings which could be realized through the use of wastepaper and de-inking facilities. Thereafter a pulp procurement authorization was amended to provide \$50,000 for the import of wastepaper. In 1961 provision was not made for the use of wastepaper despite the fact that \$6 million of aid funds were estimated by ICA for pulp procurement during that year.

The agency stated that, since the 1960 funds authorized for the import of wastepaper were not utilized, no fiscal year 1961 funds were designated for this purpose.

The agency further informed us that it has continued to sponsor the use of wastepaper in paper manufacturing but that apparently the industry does not yet fully understand or has not become convinced of its advantages.

#### Conclusion and recommendation

The above situations illustrate the danger of permitting the working of market forces to determine the commodities to be imported. (See p. 94.) Moreover, they indicate a need for more austere and realistic standards as to the types of imported commodities for which Korean foreign exchange and aid funds should be used, and a more alert screening of resources to assure their utilization for purposes of more essential and lasting benefit to the Korean economy.

We recommend that AID take appropriate measures to meet this need as it relates to aid funds and negotiate with the Korean Government for the adoption of similar measures regarding the use of Korean foreign exchange.

KOREAN GOVERNMENT RESTRICTIONS CREATED SHORTAGES  
OF GASOLINE AND AUTOMOTIVE PARTS WHICH CONTRIBUTED  
TO PILFERAGE OF MILITARY SUPPLIES

The Korean Government was unwilling to import all the gasoline that ICA estimated was needed for civilian use and consistently refused to permit the civilian economy to secure and use automotive spare parts excess to military requirements. The shortages of these items for civilian use were responsible in a significant measure for the large-scale illegal diversion of stocks of these commodities provided for the Korean and United States military forces stationed in Korea.

Gasoline

The United States financed all Korean gasoline requirements for the Korean military forces as part of the military assistance program and for the civilian economy as part of the economic assistance program.

The Korean Government refused to permit the use of ICA funds to import all the gasoline that ICA estimated was required by the civilian economy. For example, in July 1960 the Korean Government estimated its fiscal year 1961 civilian petroleum requirements at \$15 million while ICA estimated them at \$24.6 million. We were informed that underestimating requirements had been consistently practiced since the inception of the ICA program.

As a result of shortage of gasoline for civilian use, military gasoline stocks were illegally diverted to civilian use in an amount estimated by ICA in 1960 at 19 million gallons annually, valued at about \$1.9 million. This amount represents about 24 percent of the average annual issues to all United Nations and Korean military forces in Korea. The Korean Government reported that the reason for its unwillingness to import more gasoline was its desire to reduce fuel consumption by limiting the number of vehicles and by dieselizing large transport units. We were informed by ICA personnel that a principal factor in past Korean Government refusal to accept more gasoline was the government's awareness that a part of its civilian gasoline requirements could be met from black-market sources without using its limited foreign exchange or aid funds. An audit by ICA disclosed that the gasoline-rationing system was ineffective and that black-marketing and other undesirable practices, which favored certain consumers, forced other consumers to obtain their required supplies through illegal channels.

ICA advised us that the Korean Government finally accepted a realistic funding level for gasoline and other petroleum products for calendar year 1961 and was studying the possibility of eliminating the rationing system.

### Automotive spare parts

Usable automotive spare parts excess to military requirements have been scrapped or exported from Korea although there was no legitimate source of supply for a number of these parts for the civilian motor fleet. Consequently, there has been a continuing large-scale illegal diversion of automotive parts from military stocks in Korea.

Korean Government policy prohibited the re-use by the civilian economy of serviceable automotive parts removed from unusable military vehicles. These vehicles and their component parts were required to be mutilated to prevent their further use and then disposed of as scrap for steel production. This policy was designed to prevent vehicles from reaching the civilian fleet through unauthorized reassembly. However, certain of these parts were usable and necessary to maintain the existing civilian fleet, for which, in the absence of a legitimate source of supply, used parts were pilfered from military stocks or illegally diverted from the scrap pipeline. Many of these parts were not manufactured in Korea, and it was not the policy of ICA or the Korean Government to make funds available for their importation. Other parts pilfered or diverted are manufactured in Korea, and their illegal sale has unfairly competed with the legitimate auto parts industry.

Under an agreement between the Governments of the United States and Korea, excess parts from United States vehicles could not be disposed of in Korea except upon specific approval by the Korean Government. In accordance with this agreement, United States military excess parts were being exported from Korea although similar parts were not manufactured in Korea.

In December 1960, United States Army authorities, concerned about jeopardy to the combat readiness of Korean armed forces because of large-scale parts pilferage, requested, with ICA approval, the Korean Ministry of Commerce and Industry (MCI) to revise its policy to permit the sale to the civilian economy of those excess parts not manufactured in Korea. The Army proposed that those parts which would not compete with Korean production be made available for civilian needs, taking precautions to make unusable any parts, particularly vehicle frames, which could be used for vehicle reassembly.

At the time of our review, MCI had not responded to the United States Army's proposal. ICA, despite its earlier concurrence, informed us that it did not favor this proposal and would do nothing to further the proposal because it believed the proposed sale of parts would undermine Korean efforts to limit the motor vehicle fleet and would compete with the Korean auto parts industry.

- This ICA position does not appear sound since adoption of the plan would.

1. Not conflict with present Korean auto parts production. Only those parts not manufactured in Korea would be sold. United States Army records show that these types of parts were generally those which were being pilfered.
2. Provide a source of income to the Korean auto parts industry and additional revenue to the Korean Government.
3. Establish a distribution system which could control the disposal of military excess auto parts and curtail illegal competition with the auto parts industry on parts which are manufactured in Korea. The absence of such control has seriously handicapped the industry.
4. Lessen the incentive for diversion of parts from military forces in Korea.

#### Recommendation

In the light of the above considerations, we recommend that ICA reexamine its present position in this matter and actively encourage the Korean Government to permit the sale of those automotive parts that are excess to requirements of the military forces in Korea and that are not manufactured in Korea.

## PROJECT ASSISTANCE

United States aid through project assistance was widely diversified and included undertakings in practically all major sectors of the public and private economy of Korea. Direct dollar aid to project assistance amounted to \$504.6 million for the fiscal years 1954 through 1961. A listing of major projects and dollar aid financing is presented in schedule 4. ICA sharply deemphasized project assistance in the past 2 years and has been endeavoring to digest and evaluate existing projects in order to improve administration of some and terminate or cut back others. For purposes of our examination, we selected for detailed review activities in power, industry, housing, health, higher education, and vocational education because we considered them basic to any program of economic development in Korea and a representative cross section of the over-all project assistance program. Each of these activities is discussed in succeeding sections. We found that for the most part in each of these activities the projects were heavily handicapped by planning and operational deficiencies which in varying degree prevented the projects from achieving a satisfactory measure of success.

## CONTINUING POWER SHORTAGE

Electric power is one of the cornerstones of economic development in Korea. Its continued and progressively increasing shortage, in spite of substantial aid (more than \$70 million) and counterpart funds for financing power projects, has been a major deterrent to economic development. Financial instability of the power companies, caused mainly by an inadequate rate structure; extended delays in implementing aid-financed power projects; and failure to agree upon a dependable long-range power plan have deprived the power system of significantly greater capability to supply Korea's requirements. As a consequence the present industrial plant of Korea has been unable to realize its productive capacity and further industrial expansion has been inhibited.

The partition of Korea following the end of World War II deprived that part of the peninsula which subsequently became the Republic of Korea of the major source of its electric power supply. Nevertheless, ICA financed a program of industrial expansion without fully assessing the expected availability of adequate power to operate these industries. As a result, electric power has been rationed to residential and commercial customers in Korea and the shortage is expected to worsen over the next few years. Industrial facilities including those financed by ICA funds have been unable to operate fully because of a lack of power. The sections of this report which discuss the projects in industry, health, and education clearly evidence the extent of power shortage and its detrimental effects on the purposes of those projects. We understand that the Korean Government has prohibited the establishment

of new industrial plants unless they provide their own power-generating facilities.

Despite the large amount of ICA aid in this area, generating capacity has not kept pace with demand. In January 1961 an ICA contractor reported that the capacity of the generating plants was about 80,000 kilowatts less than the peak load which would be supplied if there were no load restrictions and pointed out that to keep pace with anticipated growth through 1966 an additional 484,000 kilowatts of generating capacity would be required. Mission officials reported that the power shortage is likely to increase until 1964. It was our understanding at the time we completed our field work that decisions had not been reached as to the types and locations of additional plants to meet the need for electric power.

In March 1962 the agency reported to us that it had approved a loan of \$20.9 million for a 132,000-kilowatt thermal plant at Pusan and that it was considering the expansion of the Kunsan thermal plant (see p. 123) from an original design capacity of 33,000 kilowatts to 66,000. It also reported that the Korean Government had recently taken certain actions with its own foreign exchange to alleviate the power shortage.

#### Inadequate rate structure

The Korean power system had comprised a generating company, the Korea Electric Power Company (KEPCO), and two distributing companies, the Seoul Electric Company (SECO) and the South Korea Electric Company (SKECO), which purchase the power generated by KEPCO and resell it to Korea's power consumers. Power rates charged by KEPCO to the distributing companies are subject to regulation by the Korean Ministry of Commerce and Industry. Rates charged by the distributing companies to consumers were set by the Korean National Assembly

In our prior report we commented that the power rates established by the Korean Government did not permit self-sustaining operations by the power entities and that this fact was one of the obstacles to increased Korean power production (p. 48). In 1956, KEPCO's cost of generating a kilowatt hour was 6.08 hwan (exclusive of depreciation) while its selling price to the distributing companies was 3.35 hwan.

Effective January 1, 1957, the government substantially increased electric power rates, however, concurrent increases in the price of coal and in the cost of transportation largely offset the increased power revenues. In 1957, KEPCO's fuel cost per kilowatt was approximately the same as the rate it charged for its power sales. Consequently all other direct power-generating costs as well as such indirect costs as those of depreciation, interest, and administration represented a loss to the company. The

continued unprofitable level of operations resulted in the failure of revenues to cover depreciation and other operating and maintenance costs. The company could not amortize its indebtedness nor acquire funds for new construction. Also KEPCO was unable to pay its coal supplier which in turn affected the financial standing of that company which was also a recipient of ICA aid. In addition, it was reported that the two power-distributing companies were in such poor financial condition that, for as long as 3 years, they lacked the means to finance the withdrawal from customs of ICA-financed transmission equipment valued at about \$3 million.

Recognizing that power development was being delayed because of the poor financial condition of the power companies, the United States, in return for the cash grant of \$20 million in 1961 (see p. 58, stipulated certain reforms to be taken by the Korean Government including utility rate revision. The Mission recommended an interim rate increase of 85 percent pending further study of the financial status of the power companies. The rate increase subsequently adopted by the Korean Government, in partial fulfillment of the conditions of supplemental aid, averaged only 49 percent. However, the Government planned to merge the three power companies, which it expected would result in economies in operating costs, and also to exempt the new combined company from income taxes. The Mission informed us that labor, transportation, coal, and fuel oil, all of which are major items of cost in power operations, have substantially increased since the date of its recommendation for an 85-percent rate increase. Consequently the Mission was unable to advance an opinion as to whether the 49-percent increase adopted by the Government would be sufficient to put power operations on a sound financial basis. The three power companies were consolidated into the Korea Electric Company on July 1, 1961, and substantial staff reductions and simplification of organization and operations were instituted.

#### Delays in project implementation

ICA-funded projects have experienced prolonged delays in contracting for engineering and construction services

#### Chongpyong Dam

In 1956, ICA obligated \$2 million for rehabilitation of the Chongpyong Dam, Korea's second largest hydroelectric plant, which was completed by the Japanese in 1943. The need for the project was based on a 1954 survey which found that continuing erosion of the dam made acute the danger of complete dam failure. The project contemplated that a contract would be negotiated with a selected American firm to study the problem and perform all work necessary to restore the dam to its original condition.



In 1958 and 1959 ICA obligated an additional \$4 million which was considered necessary to complete the rehabilitation of the dam. However, invitations for contract proposals were not issued until March 1961, nearly 4 years after the date at which funds for the project were originally made available and nearly 7 years after the initial survey reported an acute danger of dam failure. At the conclusion of our field work, bids received by ICA were under consideration.

Contributing to the delay in contracting was the fact that, although it had obligated funds for the project in 1956, ICA did not have all the necessary data concerning the project on which to proceed with the rehabilitation. In 1957 it employed an American engineering firm to resurvey the project; a report on this survey was not rendered until February 1959. Subsequently, there was correspondence between ICA/Washington and the Mission concerning estimated costs and the availability in Korea of construction equipment from other completed projects which could be used on this project. Further delays were occasioned by the question of whether one over-all contract should be used, or whether separate contracts for engineering and construction should be let, and by a further review of the project in August 1960 by an ICA/Washington representative.

ICA initially informed us that it expected to contract for the required services by the end of 1961 and that the project would be completed by 1964 which would be 8 years after the signing of the project agreement and 10 years after the necessity for the project was first pointed out. However in March 1962 the agency reported to us that further delay had been occasioned in 1961 by a change in procurement sources from those permitted under the President's balance of payments directive to world-wide sources; the change had been insisted upon by the Mission and the Korean Government. This change necessitated a revision of contractor proposals which the agency stated reduced the original bid by almost \$1 million.

#### Kunsan thermal power plant

In February 1958 ICA engaged an American engineering firm to select a site in southwest Korea suitable for a thermal power plant. A report was rendered in October 1958 recommending Kunsan as the most favorable site for this plant. In June 1958 a project agreement between ICA and the Korean Government committed \$2 million as an initial installment of funds for construction of a 33,000-kilowatt thermal power plant. Subsequently ICA funding was increased to a total of \$9.8 million. The Korean Government and KEPCO were to furnish the hwan funds, estimated in the equivalent of \$1.8 million, to meet the local costs of the project.

This project has been unreasonably delayed mainly because of the inordinately long period taken to complete each step in the

contract-negotiating process. It was not until March 1960 that a temporary letter agreement for the engineering was signed and a year later before a definitive contract became effective. At the conclusion of our field audit in June 1961, 3 years after signing the original project agreement, no contract for construction had been made. ICA informed us that the plant is scheduled for operation in December 1963.

The long delay in implementing the project is difficult to understand in view of an urgent dispatch from the Mission to ICA/Washington in January 1960, more than a year before the engineering contract was concluded, requesting that, in view of the increasingly serious power shortage which was affecting industrial and mining production, early action be taken to expedite conclusion of the necessary contracts.

The Mission expressed the view that contracting delays as experienced in this case would be minimized if ICA/Washington representatives and the proposed contractor could negotiate the contract in Korea with the Mission, the Korean Government, and KEPCO, rather than have negotiations conducted in Washington between the contractor and the ICA/Washington staff. The latter method, which is the standard ICA operating procedure, involves long delays in correspondence and contributes to misunderstandings because of the lack of face-to-face discussions.

The Mission also informed us that, during the period covered by the contract negotiations, the Korean Government was politically unstable with three separate governments in power and that during the period of the interim government which succeeded the Rhee Government little decisive action was taken.

The agency advised in March 1962 that, on the basis of a recent review of Korea's power-generating capacity, it was considering expanding the capacity of this plant to 66,000 kilowatts to alleviate the power shortage.

Failure to agree on dependable,  
long-range power development plan

Power development is, by nature, long-term, costly, and complex and is an integral factor in other areas of economic development. The Mission repeatedly urged the formulation of firm long-term plans for power development giving due regard to generating and transmission facilities. The Mission informed us that it was difficult to obtain agreement among the various interested Korean agencies and utility management personnel regarding power development plans. According to the Mission there has also been a tendency for the Koreans to favor hydrogenerating facilities for political and "prestige" reasons. Related to the power situation is

the need for increased production of coal used by the thermal plants which constitute most of Korea's power-generating capacity.

In April 1961 the Economic Development Council of the Korean Government announced a 5-year power plan to provide an additional 650,000 kilowatts at a cost of \$237 million of which \$127 million was to be secured from ICA and the Development Loan Fund. According to the agency this plan is not a detailed plan giving technical and economic justification for site selection and construction schedules and it contains some unrealistic calculations of natural resources, manpower capabilities, and foreign exchange earnings; however, the new government accepted it as part of its over-all 5-year development plan published in May 1961.

Questionable economic justification for  
proposed Chung-ju hydroelectric plant

One of Korea's largest power projects has been a proposed hydroelectric plant to be constructed on the Han River near the town of Chung-ju. This project was originally considered by the Japanese during their occupation of Korea and was subsequently reviewed by the United States Bureau of Reclamation in 1950 and further studied by KEPCO between 1950 and 1957. In 1957, Korea applied to the Development Loan Fund (DLF) for a loan of \$25 million to construct the proposed plant. ICA financed a review of the project by an American engineering firm, and an interim report made in November 1958 for the use of DLF stated that a suitable site was available and, on the basis of certain assumptions, the annual power costs would be somewhat less than would be incurred by a thermal power plant. In May 1959 DLF loaned KEPCO \$1.5 million for engineering design of the plant and a contractor was selected to provide the necessary engineering services. The latter contractor submitted an economic feasibility report on the project in June 1960.

Cost data submitted by KEPCO, the ICA contractor, and the DLF-financed contractor differ by substantial amounts as shown below.

|             | KEPCO<br>estimate<br>( <u>Nov. 1957</u> ) | ICA contrac-<br>tor estimate<br>( <u>July 1959</u> ) | DLF contrac-<br>tor estimate<br>( <u>June 1960</u> ) |
|-------------|---|--|--|
| Dollar cost | \$25 million                              | \$40.3 million                                       | \$57.5 million                                       |
| Hwan cost   | 12 billion                                | 14.7 billion   | 24.3 billion   |

After the submission of the DLF contractor's feasibility report, the Mission's Power Division reviewed the project and issued a report thereon in August 1960. The report raised doubts about certain economic aspects of the project, revolving basically around the question of whether it would be wiser to provide power for Korea by erecting a number of thermal power plants rather than

by completing a single hydroelectric power-generating facility. Generally, hydroelectric plants are more costly to construct but cheaper to operate. The DLF contractor estimated that the cost of the power produced by the Chung-ju hydro plant would be 65 percent of the cost of power produced by an equivalent thermal plant. Also the life of a hydro plant is considerably longer than that of a thermal plant.

The Mission expressed doubt about the validity of the three cost estimates because of their wide variance and also about the cost-benefit ratio of 1.02 to 1 computed by the DLF contractor because it believed that certain cost estimates which the contractor used were understated primarily in regard to taxes, interest, and general and administrative expenses. The Mission further questioned technical data used by the DLF contractor in regard to water flow.

A report by a United States agency, dated January 1961, questioned the wisdom of investing about \$70 million (dollar and equivalent hwan costs) in a hydroelectric plant when a thermal power plant could be constructed at a significantly lower cost. It also commented on the effect of such a costly undertaking on Korea's ability to borrow for other projects and on the delayed availability of power due to the longer construction period for a hydro plant, compared with a thermal plant.

In view of the several conflicts of views regarding various aspects of this project and the very substantial financing which it involves, we suggested that the responsible United States agencies examine all considerations relative to the pros and cons of hydro and thermal power plants as they are pertinent to the instant project before any further commitments of United States funds are made. The agency reported that, as of February 1962, a decision had been made not to finance this plant and that no consideration was then being given to the development of hydroelectric projects in the planning for the Korea Electric Company.

### Recommendation

Because of the overriding importance of power in the economic future of Korea and the very substantial investment that the aid program represents in that future, we recommend that the responsible United States agencies exert a particularly vigorous effort to (1) encourage and assist the Korean Government in the formulation of a systematic power development plan based on considered determinations of reliable cost estimates, proper locations, sizes of plants and kinds of power generation (hydro or thermal), (2) accelerate contracting and loan procedures to avoid unreasonable delays in project implementation, and (3) ascertain at the earliest practicable time whether, as a result of the recently increased

power rates and the corporate merger and other organizational changes, power operations are on a self-sustaining basis, so that if they are not further action can be initiated promptly toward making them so.

## UNSATISFACTORY RESULTS OF INDUSTRY PROGRAM

Industrial facilities financed by ICA under the small and medium industry programs were not, for the most part, being successfully operated as business enterprises. At June 30, 1961, only 14 percent of these enterprises were operating at as much as 75 percent of capacity and were current in their loan repayments. As an example, projects in the once thriving silk industry were so poorly administered that silk production actually decreased, silk filature mills were partially unused, and this industry had not made its expected increment to farmers' income or foreign exchange earnings.

### Status of program

At June 30, 1961, ICA had furnished assistance totaling about \$29 million to 214 industrial enterprises as subprojects under master project agreements between the United States and Korean Governments for promoting small and medium industries. Funds for these projects were obligated during fiscal years 1954 through 1958. ICA assistance consisted principally of financing machine tools and other capital equipment and furnishing technical assistance. In addition most of these projects received operating hwan loans from the counterpart loan fund administered by the Korea Reconstruction Bank (KRB).

ICA had not provided any funds for industry projects since fiscal year 1958. Six projects totaling about \$4 million in United States obligations were canceled between January 1 and March 31, 1961.

The status of the 214 industry enterprises at June 30, 1961, is summarized below.

| <u>Status</u>                    | <u>Number</u> | <u>Percentage of number</u> | <u>Amount of ICA assistance</u><br>(millions) |
|----------------------------------|---------------|-----------------------------|---|
| Completed and operating:         |               |                             |   |
| Over 75% of capacity:            |               |                             |   |
| No overdue loans                 | 31            | 14                          | \$ 4.8  |
| Overdue KRB loans                | 23            | 11                          | 3.8   |
| Under 75% of capacity:           |               |                             |   |
| No overdue loans                 | 23            | 11                          | 2.5   |
| Overdue KRB loans                | <u>37</u>     | <u>17</u>                   | <u>4.8</u>                                    |
|                                  | 114           | 53                          | 15.9  |
| Completed and not operating      | 29            | 14                          | 2.8   |
| Under construction               | 66            | 31                          | 9.6   |
| Letters of credit not yet opened | <u>5</u>      | <u>2</u>                    | <u>1.0</u>                                    |
| Total                            | <u>214</u>    | <u>100</u>                  | <u>\$29.3</u>                                 |

The agency pointed to the several changes in the Korean Government and in Korean exchange rates as having hampered the implementation of the industry program and informed us that as of December 15, 1961, a total of 135 projects had been completed; that, of 84 projects operating at over 75 percent of capacity, 48 had overdue loans; and that, of 51 projects operating at less than 75 percent of capacity, 36 had overdue loans. The agency estimated that the operations of these projects added 43 billion hwan to the Korean gross national product during 1961 and gave employment to more than 14,000 people.

#### Causes of unsatisfactory results

The poor showing of the industry projects was due primarily to (1) inadequate planning with respect to available raw materials and prospective markets, (2) delays in project implementation caused by slow processing of hwan loans and changes in project plans, (3) financing difficulties, such as project sponsor irregularities, excessive size of project loans in comparison with sponsor equity, and the freezing of sponsor deposits for lengthy periods, and (4) shortage of power supply. Project audits by ICA were tardy and infrequent.

#### Inadequate planning

The rehabilitation of 17 silk filature mills was undertaken without determining that a sufficient supply of silk cocoons would be available as raw material and without taking steps to see that enough mulberry trees were planted to sustain the future requirements for silk cocoons. As a result these mills operated below 50 percent of capacity during calendar year 1960. The sizable dimensions of this situation also evidenced a serious breakdown in coordination between the industry and agricultural divisions of the Mission.

ICA financed a lacquer plant although lac trees, the sole source of raw material, were only being planted at the same time that the plant was being constructed and these trees were not expected to produce sap for 6 or 7 years. A new sponsor had to be found to take over this enterprise when the original sponsor encountered serious financial difficulties while waiting for enough lac sap to begin operations. The agency advised in March 1962 that the new sponsor was continuing to plant lac trees, which had been started in 1957, and, in the meantime, had installed a small synthetic resin and varnish manufacturing unit to provide resin and varnish for local consumption.

During 1955 and 1956 ICA approved four projects amounting to \$830,000 and provided an additional \$801,000 under the nonproject import program to furnish equipment to increase the capacity of

the flour-milling industry in Korea. At the time of our review, several sponsors had gone bankrupt and this industry had a capacity four times the likely demand.

A waste silk plant, established under a program to diversify and broaden the cloth and spun yarn sectors of the silk industry, was not processing waste silk at the time of our review and is not likely to, as it had become deeply entrenched in processing worsted yarns. Poor development of domestic outlets for waste silk yarns, local demand for worsted yarn, and the financial needs of the sponsor to continue operations were the justifications advanced for the departure from the original intent of the project.

In addition, many of the delays in project implementation cited in the succeeding sections appear to have been due in large part to ill-considered planning.

#### Delays in project implementation

Slow processing of loans, protracted indecision in selecting procurement sources, and changes in project plans and project sponsors unduly delayed the execution of projects with consequent slippage in meeting project targets, substantial increases in cost, and financial hardships to project sponsors who had purchased land or otherwise used their own funds to start their projects.

The medium industry development program for fiscal year 1957 contemplated the expenditure of \$13.4 million for 50 subprojects. Subsequently 17 subprojects were canceled and \$3.9 million, the related obligation, was deobligated. Of the \$9.5 million obligated for the remaining 33 subprojects, only \$4.8 million had been expended at June 30, 1961.

In the spring of 1961, KRB made a special study of the chronological progress of 34 subprojects which then constituted the program. This study analyzed the number of days taken to process each major action from the time the sponsor made his initial deposit, which was required to accompany his application, to the time he received his counterpart loan with which to go forward with the project. The study showed that it took an average of 1,154 days, or more than 3 years, to process a project loan from application date to issuance, as follows:



| <u>Action</u>  | Average time<br>( <u>days</u> ) |
|--|---------------------------------|
| To issue project proposal and approval                           | 315                             |
| To issue authorization for import procurement                    | 337                             |
| To negotiate import procurement and to open letters<br>of credit | 244                             |
| To prepare request to CEB for release of local funds             | 120                             |
| To obtain CEB approval of request for release of<br>local funds  | 85                              |
| To request release of funds by Ministry of Finance               | 34                              |
| To obtain release of funds by Ministry of Finance                | 14                              |
| To prepare loan papers   | <u>5</u>                        |
| Total time   | <u>1,154</u>                    |

Projects for the rehabilitation of the Korean silk industry were delayed for over 2 years awaiting ICA approval of Japan as the procurement source. Mission files indicated that availability of equipment from United States sources had been thoroughly screened and that this equipment was never available from other than Japanese sources.

Plans for a silk weaving and processing plant were completely changed 2 years after the project had been approved. Substantial increases in local currency costs resulted.

Review of 10 subprojects for pharmaceutical plants disclosed that in five instances it was considered necessary to change the plant sites after the projects were initiated. Instead of rehabilitating and modernizing existing plants, as originally intended, new facilities were erected.

Delays were also caused by changes of the approved sponsors. Of the 214 active projects at the time of our review, 37, or 17 percent, had experienced sponsor changes necessitating complete refiling of all pertinent documents by the new sponsor. These changes were occasioned mainly by insufficient funds; lack of product market; and changes in management, stockholders, and company name.

#### Financing irregularities and difficulties

The Ministry of Reconstruction reported many instances of irregularities on the part of individual project sponsors or Korean Government officials, including inaccurate or false financial statements, kickbacks and rebates from suppliers, and sponsor selection based on political pressure rather than ability. These sponsors and the Korean banks responsible for ascertaining their financial position appeared reluctant to use independent auditors.

In many cases project sponsor equity in the proposed enterprise was very small in comparison with the related counterpart loans. Following are examples of loans greatly in excess of the sponsors' net assets:

| <u>Sponsor</u> | <u>Net assets</u>  | <u>Project loan</u> | <u>Number<br/>of times loan<br/>exceeds assets</u> |
|----------------|--------------------|---------------------|--|
|                | (millions of hwan) |                     |  |
| A              | 8                  | 178                 | 22   |
| B              | 10                 | 141                 | 14   |
| C              | 30                 | 350                 | 12   |

Project sponsors also suffered severe hardship in many cases because their deposits were tied up for long periods due to delays in project implementation. Upon approval of his application for a project, the applicant was required to make an initial minimum deposit of 25 percent of the estimated project cost from his resources. Deposits totaling 52 million hwan for 17 silk filature mills were tied up for from 1 to 4 years.

#### Shortage of power supply

Many industry projects were affected by a shortage of electric power which caused delays in project completion, plant shut-downs, excessive down time of machinery and equipment, and financial hardships to the project sponsors. A few representative illustrations follow: completion of a new plant for manufacturing steel furniture was delayed for approximately 4 months, a ceramic arts plant received power only every other day, and a shipyard received only 10 percent of its required power and the source of the power was over 100 miles away.

Our review indicated that availability of power supply was not sufficiently considered in determining the feasibility of the industry subprojects and in programing them; nor did there appear to have been any meaningful coordination between the program, power, and industry elements of the Mission.

#### Ineffective audit coverage

ICA audit coverage of the industry projects was both limited and untimely. Only 42 audits, involving 31 projects, were made between January 1958 and December 1960. Thirty-six of these audits were of projects financed in fiscal years 1954 and 1955. Audits after such a long passage of time are unlikely to be helpful to management control. In addition there was little ICA action on audit findings; proposals to cancel projects or request refunds rarely got beyond the discussion stage.

The agency stated that, in selecting projects for audit, attention was generally given to those known to be in difficulty and that it believed the reluctance to request refunds was natural because it felt that these projects could be salvaged under normal conditions with the cooperation of the Korean Government.

#### Proposed action and agency response

ICA has recognized that its aid to small and medium industry programs has not been used effectively and has informed the Korean Government that this is a serious problem area which requires prompt resolution. At the time of our review, it seemed unlikely that many of the enterprises financed under the small and medium industry programs would be reasonably successful for some time to come and for some enterprises the prospects seemed slight at any time in the foreseeable future. At this advanced stage of the program there appear to be no easy solutions for many of the current problems. We emphasized to ICA that it should give appropriate priority to these problems at both the Washington and the Mission level and pursue a vigorous and persistent course of positive action with the Korean Government toward their resolution, on an individual basis, in the most expeditious and beneficial manner practicable in the circumstances.

The agency reported to us in March 1962 that many steps had been taken to resolve the problems of this program, including (1) setting up additional operating funds, (2) changes in sponsorship, (3) auctions of nonoperating projects, (4) taking over and operating projects under the supervision of Korean Government agencies, and (5) review of the entire industry program on a case-by-case basis with a view to possible refund requests or cancellations where appropriate.

MAJOR HOUSING PROJECTS HAD NOT ACHIEVED  
THEIR INTENDED GOALS

United States assistance in housing comprised a number of individual projects. Our review was directed to the projects in the long-range program and to one large emergency subproject for the repair of typhoon damage. Other housing assistance not included in our review represented construction projects principally for slum clearance and for the resettlement of displaced persons and the assimilation of refugees.

Of the three projects which composed the long-range housing program, the major one, involving the construction of housing, had fallen far behind the timetable fixed for completed units; another, for promoting building-material plants, was to be terminated for lack of qualified sponsors; and the third one, for housing research and development, had not undertaken its primary function. The emergency subproject, added to the construction project, for reconstruction of housing because of typhoon damage had benefited relatively few families 2 years after the typhoon. An important factor in the delay of the construction project was the procurement of lumber that was unsatisfactory for the purpose intended.

Composition of program

During fiscal year 1957, ICA and the Korean Government initiated a 6-year housing program designed to reduce Korea's critical housing shortage and contribute to a permanent solution of housing problems. The program consisted basically of three projects with agreed dollar financing of imported materials and equipment, technical assistance, training of Korean participants by ICA, and financing of local costs from counterpart funds and the Korean budget and end-users. Program funding as of December 31, 1960, was as follows:

|   | <u>ICA<br/>assistance</u> | <u>Counterpart<br/>funds</u> | <u>Korean budget<br/>funds and<br/>funds of<br/>end-users</u> |
|---|---------------------------|------------------------------|---|
| <u>Project</u>                          | (thousands<br>of dollars) | (millions of hwan)           |   |
| Housing construction                    |                           |                              |   |
| Low- and moderate-cost housing          | \$2,961                   | 18,581                       | 18,672  |
| Minimum-cost housing                    | 439                       | 140                          | 1,850   |
| Typhoon rehabilitation                  | <u>1,950</u>              | <u>-</u>                     | <u>1,900</u>  |
| Total                                   | 5,350                     | 18,721                       | 22,422  |
| Development of building-material plants | 244                       | 87                           | 53  |
| Housing research and development        | <u>167</u>                | <u>268</u>                   | <u>25</u>   |
| Total                                   | <u>\$5,761</u>            | <u>19,076</u>                | <u>22,500</u>   |

## Housing construction

This project contemplated two types of housing construction, designated as (1) low- and moderate-cost housing and (2) minimum-cost housing. The former, which was the major type, was for owner occupancy by local residents of low-moderate income who were in need of housing and agreed to live in the house for at least 5 years. Long-term loans (15-year maximum) from the Housing and Home Development Fund (HHDF), administered by the Korean Reconstruction Bank, were available to (1) cooperatives for their eligible members, (2) local governments, companies, and institutions for sale at no profit to eligible residents and employees, and (3) eligible individuals (since 1959). Short-term loans (1-year maximum) could be obtained from the HHDF by builders for construction of houses for sale at a reasonable profit to eligible individuals.

At July 31, 1961, only 5,746 of the 9,700 low- and moderate-cost housing units planned in the fiscal year 1957-59 programs had been completed. None of the 3,000 units planned in fiscal year 1960 had been started as of December 31, 1960. Processing of loan applications was extremely slow because of inefficient and time-consuming procedures within the Korean Government. A partial remedy was instituted in 1958 when applications were processed direct to the KRB rather than through the Ministry of Health and Social Affairs (MOHSA).

Material procurement was slow, ill-timed, and in some cases unsatisfactory. Procurement authorization orders were usually not issued for 6 months, and in some cases 12 months or more, after the date of the project agreements. Subsequently much of the material was received near or after the end of the following building season. In one case almost six million board feet of lumber was received near the end of the second building season after the obligation of funds. About two million board feet of hardwood lumber, purchased at a cost of more than \$320,000, was delivered during the latter half of 1960 but was not used on the subproject as intended. According to the agency the lumber specified for this procurement was Philippine lauan (mahogany), a lumber very much in demand for housing construction in Korea. The conditions regulating world-wide procurement, normally employed, resulted in the substitution of other lumber. When home builders obtaining the HHDF loans found that they were unable to obtain Philippine lauan under their loans, they withdrew their requests, preferring to procure lauan on the open market. The other lumber was subsequently shifted to minimum-cost housing and utilized under the Korean slum clearance project for 1,750 units.

The agency claimed that delays in the issuance of procurement documents did not slow the construction program as necessary materials were borrowed from United States Army and other Mission

projects. This arrangement undoubtedly alleviated but did not overcome construction delays as is evident from the slippage in construction described above.

In 1959 minimum-cost housing was included in the long-range program for families which qualified for but had not received aid under the 1957 project for displaced persons. Borrowers agreed to furnish the labor for construction of their homes on land already owned or under long-term leases. The houses were limited to about 300 square feet per house which was less than half the size of low- and moderate-cost housing.

Although 3,950 self-help housing units were planned, only 1,406 units had been completed and 1,707 units were in construction at July 31, 1961. Much of the imported material had been loaned to the special subproject for reconstruction of typhoon-damaged housing because of implementing difficulties; namely, the Mission was unable to obtain adequate cooperation of the Korean Government and sufficient Mission advisory personnel.

A special subproject to assist in housing reconstruction after the September 1959 typhoon damage was included in the fiscal year 1960 program. Eligibility criteria were basically the same as under the minimum-cost housing subproject. The assistance was primarily for the southeastern section of Korea around Pusan and consisted of allocations of United States dollar-funded cement and lumber and of Korean Government local currency for 19,000 families whose homes suffered typhoon damage.

As of September 1961, 2 years after the typhoon, only 16 percent of the 19,000 families had received all the assistance planned. All the families received the allotted cement and the local currency provided by the Korean Government for construction costs, but only 3,000 received lumber which was borrowed from the minimum-cost housing subproject.

According to the agency, unforeseen delay in obtaining ICA/Washington approval for the dollar allocation for this subproject was a major factor in delaying procurement and distribution of the imported materials for housing reconstruction but this delay was partially compensated by utilizing for this purpose other materials already on hand which had been imported under other projects and were not immediately required or were surplus. The agency further stated that the remaining 16,000 families subsequently received the United States dollar-funded lumber allocation.

With respect to other housing construction, Mission reports show that 3,200 units of the resettlement and assimilation projects had been completed at July 31, 1961, and that 1,750 units of the slum clearance projects were under construction at that date and all had been completed at February 28, 1962.

### Development of building material plants

This project was designed to enable manufacturers of building materials to obtain loans with which (1) to pay into the counterpart fund the local currency equivalent of the dollar costs of needed machinery and equipment to be imported under ICA financing and (2) to defray other local costs. The borrower was required to invest a minimum of 20 percent of the combined dollar and local currency costs. The loans were to be administered by the KRB in accordance with the financing regulations and procedures for loans under the small and medium industry programs. (See page 128.) In fiscal year 1957, \$500,000 was obligated by ICA to finance commodities and 200 million hwan was allocated from the counterpart account for the initial operations, planned for completion at the end of 1957, with a contemplated addition of \$900,000 during the next two fiscal years.

The funds had been obligated prior to initiating a materials survey which was to be used as a basis for selection of the plants to be developed. A task order for this survey was not issued to the consultant firm until August 1958. The survey personnel arrived in Korea in January 1959, and a final report was submitted to the Mission in September 1959. Because very few loan applications had been processed, ICA deobligated \$256,000 during 1960 and the allocated counterpart was reduced by 113 million hwan. At June 30, 1961, no equipment had been imported and no funds had been expended. We were informed by ICA that this project was to be terminated except as it concerned two manufacturers who were determined eligible. Total obligations which at June 30, 1961, amounted to \$244,000, were to be further reduced to an estimated \$100,000.

### Housing research and development

The purpose of this project was to contribute a wider knowledge and employment of improved building materials and designs and to obtain more adequate housing legislation, policies, and planning and improved administration, organization, and technical services in the housing sector, as an integral part of the country's long-range housing plan.

Dollar funds were obligated in the amount of \$90,000 for advisory personnel, \$33,000 for the training in foreign countries of Korean participants, and \$44,000 for the importation of commodities for construction of demonstration housing. An additional \$86,000 obligated for commodities was deobligated after delays experienced by the Mission and the Korean Government in completing agreements, plans, and specifications for research and development work.

Counterpart funds in the amount of 248 million hwan had been approved to finance national housing competitions, housing surveys, and the development and dissemination of housing publications. An additional 20 million hwan was approved to finance internal handling costs of imported commodities.

Activities under this project consisted of holding two national housing design competitions, assisting in three housing demonstration projects, training five participants in the United States, conducting a national housing essay contest in the Korean schools, and publishing literature pertaining to United States housing legislation and housing in Korea. However, the types of research and development contemplated for the project were not undertaken and no housing surveys were made. Efforts to have adequate housing legislation instituted were not successful.

#### Agency comments

The Mission had recognized that the instant projects had not been successful but stressed that the critical housing shortage in Korea underscored the need to continue the housing program provided that future implementation could be achieved in a more satisfactory manner. The Mission further stated that its housing program was to be reviewed and that the intentions and plans of the new Korean Government, together with commitments, were to be obtained. The composition and extent of the future housing program would depend upon the results of these actions.

The agency reported that, on the basis of a review of the Korean housing programs, it was anticipated that no further dollar financing would be made available and continuing activities in housing construction, research, and development would be financed with counterpart funds.



PROJECT FOR CONSTRUCTION OF NEW HEALTH FACILITIES  
WAS POORLY PLANNED AND ADMINISTERED

Although estimated for completion by mid-1957, very few of the hospitals, health centers, and other facilities included in this project were operating satisfactorily at June 30, 1961. Some of the structures were not finished; others were either improperly constructed or lacked adequate utilities for successful operation. Much of the equipment for these facilities was still at the port of entry or was unused at the building site.

As a supplement to earlier projects for reconstructing existing facilities damaged in the Korean war, the health facilities improvement project was initiated in fiscal year 1956 to construct and equip new medical facilities. A 3-year program was originally contemplated. The first phase, to be completed by June 30, 1957, encompassed 29 facilities, including a mental hospital, a tuberculosis sanatorium, health centers, and provincial hospitals. In 1956, \$700,000 was obligated and more than 400 million hwan in counterpart was allocated to finance the first phase. These amounts proved to be too low, additional funds had to be provided, and the first phase became the entire project with minor changes. As of June 1961, a total of \$2.2 million had been obligated by ICA and 1.7 billion hwan had been allocated for 30 facilities. At the time of our review the project was still uncompleted.

The largest individual facility under the project is a mental hospital. Originally, \$224,000 was obligated by ICA and more than 100 million hwan was allocated from counterpart funds for a 500-bed hospital. The amounts were grossly insufficient as evidenced by the fact that a 300-bed hospital was being constructed at a cost to date of about 1 million dollars and 600 million hwan in counterpart. Construction began late in 1957, was suspended for a year because of a reported lack of funds, and was estimated for completion in December 1961. Equipment furnished by ICA was stored at the project site pending completion of construction.

Other facilities had not been completed at the time of our review in June 1961 or they could not be used efficiently because of limited water and power supply. Some of the equipment for these facilities was still stored at the port of entry in Korea because construction had not sufficiently advanced to enable installation. Mission officials reported that in many instances these facilities had been poorly constructed. A laboratory to produce tuberculosis vaccine was planned for completion late in 1959 so that foreign exchange would not have to be used to import vaccine in 1960. At the time of our review installation of laboratory equipment had just been completed and trial production runs were beginning. The agency attributed the delay to several changes in top officials of the Korean Ministry of Health.

The agency advised in July 1962 that construction of all facilities had been completed and at least basic staff and budget had been provided by the Korean Central and Provincial Governments. The agency also advised that the mental hospital was completed in December 1961 and that the vaccine laboratory estimated production of 4 million doses in 1962.

### Conclusion

From our examination it seems clear that this project received little if any considered planning, that technical supervision and management control were very limited, and that the funds were obligated considerably before the project was ready to use them. The record indicates that at the time the initial funds were obligated neither engineering plans nor cost estimates had been developed in anything more than skeleton form.

### PROBLEMS IN HIGHER EDUCATION PROGRAM

The curriculum at the College of Engineering at Seoul National University (SNU) was developed without direct knowledge of the types of engineers and scientists needed in Korea. As a consequence Korean economic development probably did not receive the full potential benefits of this branch of higher education; moreover assistance was given to courses which appeared to make a relatively small contribution toward existing and foreseeable Korean economic requirements. In addition much of the equipment furnished under the program had not been installed and other equipment had not been utilized because of the lack of power and heat.

### Background and composition of program

The project for assistance to SNU covered the Colleges of Engineering, Agriculture, Medicine, and Public Administration and encompassed three types of activities involving United States dollar financing of commodities and technical services and counterpart and Korean budget funds for local costs. United States dollar obligations and local currency allocations to June 30, 1961, for each of these activities are summarized below.

|   | Dollar<br>obligations | Local<br>currency allocations<br><u>Counterpart</u> <u>Korean budget</u> |
|---|-----------------------|--|
|   | (millions)            |  |
| Advisory services and training<br>under contract with United<br>States university | \$3 5                 | 4            -   |
| Procurement of books, supplies,<br>and laboratory and classroom<br>equipment      | 2 9                   | -            777   |
| Repair and rehabilitation of<br>SNU plant   | 3 0                   | 3,579      304   |
| Total   | <u>\$9 4</u>          | <u>3,583</u> <u>1,081</u>  |

The contract with the United States university executed in 1954 called for:

1. Technical personnel to act as advisors in Korea to the colleges of SNU.
2. Korean faculty members to receive training in the United States at selected universities.

The contract originally for 3 years was extended several times; it expired on June 30, 1961, for the Colleges of Engineering, Agriculture, and Medicine and ran to June 30, 1962, for the College of Public Administration. Under amendments in 1955 and 1956, the services of the university were engaged for the procurement of laboratory and classroom equipment. The university was also requested to advise in developing plans for the rehabilitation of the SNU plant.

### College of Engineering

Our review was directed for the most part to the project activities--contract services, equipment procurement, and plant rehabilitation--in the College of Engineering which in 1960 had an enrollment of 1,580 students. Dollar and local currency financing for these activities totaled \$1.79 million and 1,450 million hwan through June 30, 1961.

A joint ICA/Korean Government report in 1960 on a study of higher education in Korea stated that the reason so few graduates in science and engineering find employment in their fields is because there are too many graduates for the current state of the economy and the qualifications of the graduates are low. The report further pointed out that a comprehensive survey should be undertaken of all Korean industries and government agencies to obtain an estimate of the number and type of engineers and scientists that would be needed in the future.

United States financing to the engineering college provided equipment for such courses as Naval Architecture and Marine Engineering, Aeronautical Engineering, and Nuclear Engineering. These courses would seem to offer very limited employment opportunities and to have an unimportant place in the Korean educational picture in terms of their present and foreseeable economic value to the country. Considering the extensive needs of Korea in the essential sectors of its economy, the financing of equipment for and the attendant encouragement of such courses as those named above did not appear to be consistent with the most beneficial use of aid funds. This equipment included such items as a subsonic wind tunnel, together with construction of a special facility for housing it, and a towing tank used for instructional and research purposes in ship design.

The majority of ICA-furnished equipment had not been set up and put in use on a permanent basis because of the lack of counterpart funds to pay for installation. Furthermore no facilities (machine shop and staff of mechanics) had been established for required maintenance of this equipment. Equipment purchases for the College of Engineering amounted to \$1,370,000. According to the final report of the university contract advisor in June 1961, more than 194 million hwan was required to complete the installation of the laboratory equipment.

The shortage of support utilities such as power, heat, and water seriously handicapped the effective use of the college laboratories and other facilities. Power outages were frequent, prolonged, and detrimental to the conduct of classes, especially for laboratory work. The dean of the college reported that only 85 kw, or 46 percent of the required 184 kw of power supply, was available. According to the Mission, rationing of power will be necessary until 1964. During two to three of the coldest months of the year subfreezing temperatures prevented the use of water in the laboratories. The lack of adequate heat for 3 or 4 months greatly retarded the efficient use of the laboratories for teaching or for research.

#### Proposed action and agency response

In view of the highly important role of education in the economic development of Korea, and in the interest of the most effective utilization of aid funds, we advised ICA that it should devote the most energetic effort toward (1) encouraging education at the college level in such fields as will be in reasonable balance with the immediate and near future economic needs and employment opportunities of the country, (2) installing equipment and providing adequate maintenance facilities, and (3) obtaining by such means as may be feasible, including reasonable temporary means, the required supply of power, water, and heat. We also stated that the agency should follow through with the Korean Government on the recommended survey of requirements for engineers and scientists and on such action as the results of the survey may indicate to be appropriate.

We pointed out to the agency that the termination of the university contract at June 30, 1961, placed the burden of the above tasks directly upon it with the resulting responsibility of providing such qualified personnel as may be necessary to carry out these tasks.

#### Agency comments

The response of the agency to the conditions described above is summarized as follows:

The initial efforts of the agency to improve the College of Engineering were based upon the most reliable information obtainable at the time and the extreme scarcity of qualified civil, mechanical, and electrical engineers needed for restoration and advancement after war devastated the country.

Under the agency's recently revised education program in Korea, academic training is being deemphasized and attention is being focused on vocational education needs. In line with this shift, the contract with Seoul National University, the secondary school project, 60 percent of scholarship grants, and all but one of the ICA educational advisory positions are being terminated. This turnaround has coincided with the revamping by the present government of the Korean educational system, which involves the introduction in all elementary schools of vocational training and the reduction of college enrollments from 145,000 to 50,000 of which two thirds are to be channeled to technical and vocational junior colleges.

As of January 1962, two thirds of the equipment had been installed and local currency funds had been budgeted in 1962 to complete the installation.

In March 1962 the power situation had been improved and a new substation was expected to be completed shortly to supply power to the Atomic Energy Laboratory and the Seoul National University College of Engineering.

## UNSUCCESSFUL EXPANSION OF GOVERNMENT-CONTROLLED SHIPYARD

The Dae Han Shipbuilding Corporation (Pusan Iron Works), which received ICA-financed equipment and machine tools amounting to about \$2 million was operating on a very limited scale and much of the ICA-furnished equipment was idle. Although ICA and the Korean Government had recognized for several years the need for reorganizing and refinancing this corporation, such had not been done at the time of our review.

The Dae Han Shipbuilding Corporation (DHSC) is a former Japanese enterprise now operated by the Korean Government which owns more than 97 percent of the corporation's stock. ICA committed \$2 million in June 1955 to purchase equipment in connection with the expansion of the shipyard, including a modern foundry and a machine shop.

The project had little, if any, planning as to basic requisites such as (1) the needs of the country for the various types of operations which were established or expanded, (2) the channeling of required needs of other government units to the corporation rather than outside the country, (3) the coordination of operational capacity with the limited power availability, (4) the competency of local management, and (5) the financial status and requirements of the corporation.

As a consequence the facility was largely idle while at the same time Korean ships were being repaired abroad, duplicate machine tool facilities were being established by the Korean military forces, and products that could be manufactured by DHSC were being imported. Some equipment could not be used because of a shortage of electric power. DHSC encountered financial difficulties and was unable to pay the duty on the ICA-financed equipment. At the time of our visit the equipment was located in the shipyard plant and we were informed by the agency that in 1958 the Korean Government authorized the shipyard to install and make full use of the equipment without prior payment of the duty.

### Low scale of operations

DHSC was operating substantially below its capacity at the time of our review in June 1961 as indicated by the following production data:

| <u>Area</u>       | <u>Capacity</u>   | <u>Current production</u> |
|-------------------|-------------------|---------------------------|
| Ship construction | 3,000 tons a year | None                      |
| Ship repair       | 150,000 " " "     | 1/3                       |
| Machine Shop:     |                   |                           |
| Cast steel        | 300 " " "         | None                      |
| Forging           | 300 " " "         | Limited                   |
| Machinery work    | 18,000 man-days   | 1/3 or less               |

ICA officials informed us that DHSC is one of the best equipped plants in the Far East for the construction and repair of small ocean-going and coastal vessels, as well as for the repair of large ships. In addition, DHSC has the potential to manufacture or fabricate in its shops a multitude of other products such as cast iron pipe and castings of all types; heating equipment; various steel works such as bridge and structural girders; various types of machine tools; and components and replacement parts for the chemical, mining, transportation and textile industries, for power plants, for water supply systems, and for other similar purposes.

According to the Mission, in November 1960 approximately 75 percent of the ICA-financed equipment, valued at \$2 million, had been idle for nearly 3 years.

#### Need for reorganization

For a number of years both ICA and the Korean Government had recognized the need for corporate reorganization, including refinancing. In August 1958, ICA officials stated that:

\*\*\* the plant could be operated economically under a capable and reliable top management after a financial reorganization, some technical assistance and other safeguards \*\*\*."

DHSC paid 700 million hwan toward the cost of ICA-financed equipment, 15 percent from its own funds and the balance--594 million hwan--through a counterpart loan from the Korean Reconstruction Bank. In addition, 368 million hwan was made available from counterpart funds to finance installation of the equipment. In 1959, 960 million hwan more of counterpart funds was borrowed for working capital and part payment of other obligations.

Financial statements at December 31, 1960, showed the above counterpart loans as totaling 1.9 billion hwan with accrued interest payable of 156 million hwan. Other industrial loans and notes and accrued interest totaled 2.3 billion hwan, resulting in a debt

structure of over 4.3 billion hwan (\$3.3 million at 1,300 hwan to \$1). According to the agency, interest charges were accruing at more than 200 million hwan annually. For the calendar years 1957 through 1960, DHSC operated at annual losses which for the 4 years aggregated more than 1 billion hwan. A Mission audit report issued in 1959 sharply criticized the Mission for insufficient consideration, during the planning stage, of the effect of the loans and the related interest burden on the financial resources and future earnings of DHSC.

A reorganization plan agreeable to both ICA and the Korean Government was developed in May 1961. This plan included:

1. Conversion to private management by public sale, or lease to a foreign firm or group.
2. Government guarantees including tax exemption of shipbuilding material, restrictions on the flow of business to foreign countries, ease of foreign exchange, shipbuilding subsidies, and financing.
3. Interest exemption on Korean Reconstruction Bank loans, extension of repayment period, cancellation of outstanding import duties, and permission to dispose of excess properties.

Action on this plan which was to be completed by the end of May was halted upon the change in the Korean Government in May 1961.

In March 1962, the agency informed us that the Korean Government had set aside funds in its 1962 budget which the agency feels should satisfy the financial requirements of this facility, that the Korean Government had agreed to waive all customs duties and taxes on the aforesaid ICA-financed equipment, and that additional power had been recently made available at Pusan.

#### Korean ships repaired and constructed abroad

In spite of the fact that the ship repair division of DHSC was operating well below its capacity, government and privately owned Korean ships were being repaired in facilities outside Korea. During 1960 nine vessels owned by the Korea Shipping Corporation (KSC), a government-controlled corporation, were repaired outside Korea at an estimated cost of \$172,000, and plans in 1961 called for the repair in Japanese yards of five ships owned by KSC at an estimated cost of \$235,000. We were informed by ICA officials that DHSC could have made these repairs.

The United States Military Sea Transportation Service (MSTS) had considered having its ships repaired by DHSC but decided in



1958 not to do so because welders in Korea were not certified by the American Bureau of Shipping (ABS) and some repairs performed in Korea had been condemned. However, subsequent to 1958, welders at DHSC were certified by ABS, and repairs to a number of ships in 1960 and 1961 were surveyed by ABS and others. DHSC still had not performed any work for MSTIS although the latter had been approached after certification had been received.

On the other hand, the United Nations Command in Korea had directed that United States Army ships in the area be repaired in Korea. At the time of our review this policy had resulted in repair work during 1960 valued at about \$73,000, and during 1961 at about \$18,000.

Although DHSC's estimated annual shipbuilding capacity is 3,000 tons, a total of only 1,939 tons has been constructed since the start of operations in 1950. According to DHSC personnel, the yard can construct ships of up to 3,000 tons each.

A recent DHSC report pointed out that a contract had just been let by the Korean Government for the construction in Japan of one 50-ton customs patrol boat and one 100-ton police patrol boat. ICA correspondence in 1959 indicated that a Korean fishing company received in April two 80-ton fishing vessels which had been ICA-financed and built in Japan.

#### Duplicate machine tool facilities

Both the Korean Army and Navy were expanding and modernizing their machine tool facilities even though DHSC machine shops, located in the same area, were largely unused. These military installations were being equipped with machine tools received under the military assistance program.

The Engineer Maintenance Depot in Pusan was planning at the time of our review to move into a new facility and had recently received some new machine tools including dynamotors, a metalizing machine, a heat-treating furnace, and a metal planer. ICA officials informed us that similar equipment was already installed at DHSC. In addition, about \$50,000 worth of machine tools was expected to be delivered for the new engineer facility, including a lathe engine, threading machines, honing machines, grinders, and welding machines.

Although agreement was reached a number of years ago for DHSC to accomplish some machine work for the Korean Army Engineers, we were informed by United States military advisors that the Army Engineers had obtained machining equipment and was doing its own work.

A machine tool replacement program was also under way at the nearby Korean Navy ship repair facility at Chinhae. Equipment valued at about \$200,000 had been delivered under the military assistance program. Items received during 1959 and 1960 included lathes, grinders, boring machines, a milling machine, and a heavy-duty shear. Machinery expected to be received under the same program included bench grinders, lathes, milling machines, and a sheet metal brake. Also, installation plans called for additional equipment valued at \$104,000, including an air compressor, a microfilm setup, foundry improvements, laboratory equipment, a cutoff abrasive machine, and a bending machine. According to ICA officials, DHSC had almost all of this equipment in its shops.

Products imported that could be manufactured

DHSC's potential for shop work manufacturing included:

- Semidiesel and diesel engines, 5 HP to 300 HP
- Various types of machine tools
- Structural steel work
- Cast iron pipes
- Steel rods and bars
- Screws and bolts
- Radiators and heating systems
- Stoves and boilers
- Sanitary and drainage pipes
- Water pumps and valves
- Air compressors
- Forgings
- Castings
- Building and ship hardware
- Water and oil storage tanks
- Water meters
- Concrete mixers
- Other--fabrication of spare parts for transportation equipment, weaving mills, heavy industry, mining industry, etc.

Our discussions with United States military advisors disclosed that many of these items were being procured outside Korea under the military assistance program. For example, 19.4 million lineal feet of steel rods were on order at the time of our review at the Korean Army Engineer Depot. The Engineer Maintenance Depot needed heat-treated nuts and bolts which could be supplied by DHSC. United States military advisors stated that the Korean Ordnance Corps used many items shown in the above listing, particularly transportation equipment spare parts which were being delivered under the military assistance program.

## Recommendations

The situation at DHSC as described above represents a significant and unwarranted burden on the Korean economy with consequent deterrence to economic development and the effectiveness of United States aid. We recommend that the responsible United States agencies strongly urge the Korean Government to (1) expedite reorganization of DHSC along the lines agreed upon in May 1961, (2) arrange for maximum procurement from DHSC by other Korean agencies of all those products and services now procured from outside Korea which are available at DHSC, and (3) initiate a study with assistance by ICA and United States military advisors to determine quantitatively and qualitatively those items that DHSC can supply to the Korean military services which are now imported under the military assistance program. In a separate report to be issued to the Congress on our review of the local currency military budget support program for Korea, we plan to recommend that the Department of Defense in coordination with ICA reappraise the basis for providing and supporting machine tool facilities within the Korean military forces which duplicate facilities at DHSC.

## LIMITED SUCCESS OF VOCATIONAL EDUCATION PROGRAM

Despite Korea's urgent need for skilled workers and technicians, the vocational education program had little success in developing trade skills. Because of poor planning, implementation, and country cooperation, much of the equipment provided by ICA for more than 50 schools had not been used effectively. In recognition of this unsatisfactory progress, ICA decided in 1960 to concentrate on one technical school in Seoul which would serve as a national demonstration center.

The United Nations Korea Relief Agency began assisting 19 technical high schools in 1952. In recognition of Korea's need for more technicians in the development and growth of her industries, ICA took over the program in 1956. Assistance through June 30, 1961, amounted to \$2.6 million, chiefly for imports of equipment and construction materials, and 1.2 billion hwan from the counterpart account, for local expenses. This project assisted more than 50 schools all of which were furnished equipment and about 30 of which were supplied with materials for expansion of their facilities.

The project appears to have lacked studied planning. The specific occupations needed by the Korean economy were not considered and equipment was purchased before agreement was reached on the appropriate curricula. Korean education has traditionally been oriented toward collegiate type or theoretical training, with shop or plant training considered inferior or not suitable for capable youth. Hence, many of the schools being assisted allocated little time for the use of ICA-financed equipment as a practical application of theory. Only about 8 percent of the students' time was spent on shop work.

Procurement was not well coordinated so that equipment would be delivered reasonably proximate to the completion of related construction. School equipment was ordered at approximately the same time as construction materials and upon receipt had to be stored for long periods while school facilities were being constructed. Eight of thirty schools which we reviewed had received equipment at least 12 months or more before completion of sufficient facilities for their installation. At the Samchock Technical High School, to which equipment with the second largest total value was furnished, electric shop equipment costing almost \$60,000 was stored for 2-1/2 years, machine shop equipment costing \$80,000 for 1 year, and woodworking equipment worth \$7,000 for at least 2 years.

Some schools for which equipment was furnished did not have the power or other utilities to operate effectively. At the time of our review Seoul Technical High School, which was the prime school being aided in the program, was without electrical power

every other day. Samchock Technical High School could not demonstrate the use of approximately \$16,000 worth of its furnished electrical equipment because of inadequate electrical wiring. At the latter school, the woodworking shop was idle because the shop did not have lumber for practice materials.

In 1960 ICA recognized the unsatisfactory progress of the program and decided to concentrate its advisory assistance on one vocational school, the Seoul Technical High School. ICA informed us that in this way the program would provide a national demonstration school so that the teachers trained, methods developed, and instructional materials written in that school would serve as models for other schools. We were informed also that the Korean Ministry of Education was conducting a national survey of occupations available for vocationally trained graduates in industry and the skill requirements for these occupations.

The agency advised, in March 1962, that (1) all equipment furnished the Korean technical high schools had been installed, (2) wiring had been renewed at the Samchock Technical High School, and (3) stand-by generators had been installed at the Seoul Technical High School. The agency further stated that the Korean Ministry of Education with the assistance of the Mission was working on a program under which shop students would spend more hours per week in shop practice utilizing ICA-financed equipment.

## LOCAL CURRENCY

The manner in which counterpart funds were generated and the purposes for which they were allocated are described beginning at page 60. Counterpart funds and other local currencies derived from surplus agricultural commodities which were allocated to the support of Korean national defense are administered by MAAG. Our review of this support program disclosed a failure on the part of involved United States agencies to implement appropriate controls over budget support funds, together with serious deficiencies in the administration of these funds by the Republic of Korea Army. This review will be the subject of a separate report to be issued to the Congress.

In other areas of counterpart operations which are the responsibility of ICA through the Mission, we found that (1) the Mission did not have control over the deposit of counterpart funds adequate to follow up on substantial differences between the amounts due and the amounts deposited and (2) the Mission exercised little surveillance over counterpart loans administered by KRB although the need therefor appeared evident from our review.

These subjects are discussed briefly below.

### INADEQUATE CONTROL OVER DEPOSIT OF COUNTERPART FUNDS

Although the total amounts deposited into the counterpart deposit account were consistently and substantially less than the total amounts required to be deposited, the records and procedures of the Mission were not organized to enable ready determination of the difference or what it represented. Thus the Mission was not in a position to know whether the local currency side of the commodity import program was being satisfactorily administered, particularly in such important aspects as timely and full deposits and the expeditious movement of aid-financed commodities into the Korean economy based on deposits made or due on individual commodity shipments.

This situation had existed since the early years of the program and was pointed out in our previous report issued in 1957. In that report we stated that reliance as to deposits was placed principally on Korean reports which were unreliable and were not being reconciled with the records of the Mission. Our current examination found the situation substantially unchanged.

In 1958 the Mission audit unit attempted to reconcile required deposits with actual deposits. The reconciliation disclosed that the required deposits exceeded actual deposits by 29.9 billion hwan. The Mission informed us that it had informally

apprised Korean officials of the difference and that for a temporary period thereafter deposits increased.

At the conclusion of our field work in June 1961, the Mission was engaged in another reconciliation for the period from fiscal year 1954 through December 31, 1960. Tentative results indicated a difference of 46.8 billion hwan, equivalent to \$36 million at the current exchange rate of 1,300 hwan to \$1.

The Mission expressed the belief that most of the difference represented a lag in deposits mainly for fertilizer imports and for other commodities in customs and that, while the lag might be longer than it should be, it would eventually clear up. A review which we made of a random selection of procurement authorizations showed significant differences between required and actual deposits applicable to commodities imported several years ago. The following cases are illustrative.

| <u>Year</u>        | <u>Procurement<br/>authoriza-<br/>tion</u> | <u>Commodity</u>                  | <u>Required<br/>deposit</u> | <u>Actual<br/>deposit</u> | <u>Differ-<br/>ence</u> |
|--------------------|--|-----------------------------------|-----------------------------|---------------------------|-------------------------|
| (millions of hwan) |  |                                   |                             |                           |                         |
| 1954               | 4259                                       | Lumber and<br>sawmill<br>products | 415.3                       | 5.5                       | 409.8                   |
| 1955               | 5001                                       | Fertilizer                        | 2161.8                      | 717.3                     | 1444.5                  |
| 1956               | 6009                                       | Fertilizer                        | 8726.6                      | 7518.0                    | 1208.6                  |
| 1957               | 7285                                       | Coal                              | 228.2                       | 0                         | 228.2                   |

The required amount of counterpart deposits was changed from the amount of commensurate value to the amount of sales proceeds effective January 1, 1961, and incident thereto the Mission developed revised accounting and reporting procedures which were intended to provide, among other things, more effective control of counterpart deposits. At June 1961, when we completed our field work, the revised procedures had not been put into operation.

#### Proposed action and agency response

In the light of the conditions described above, we suggested to the agency that the Mission (1) complete the reconciliation of required and actual deposits in which it was engaged and take positive measures for settling the differences and (2) put into effect the revised procedures for accounting, reporting, and controlling counterpart deposits.

The agency advised in March 1962, that (1) counterpart billings, deposits, and withdrawals through August 31, 1961, had been

reconciled by the Mission Controller's Office and (2) current negotiations were being held with the Korean Government to simplify billing and deposit procedures. With regard to arrears in counterpart deposits, AID stated that it was weighing the cost to the Korean economy of requiring collection and deposit of such arrears against the cost to the aid program of agreeing to write off these arrears as an acknowledged subsidy not originally anticipated in the United States aid program.

FAULTY ADMINISTRATION AND CONTROL  
OF COUNTERPART LOAN PROGRAM

Our review of the counterpart loan program administered by the Korean Reconstruction Bank (KRB) indicated several areas of deficient operation by KRB and a want of necessary over-all monitoring by the Mission. Many loans were delinquent as to principal and interest and some loans appeared to have been of questionable financial risk. We noted several instances in which principal and interest payments were not deposited promptly into the counterpart account; service charges were being taken on loans in arrears, contrary to CEB authorization; and penalty interest collected was being improperly retained by KRB for its own account. The Mission had not made and did not have plans for any audits of the eight revolving funds administered by the three government controlled banks (KRB, Bank of Korea, and Korean Agricultural Bank). Except to the extent required in audits of ICA-financed projects, the Mission had not made any audits of other loans under the counterpart loan program and had not examined the banks' lending practices. The fund and status reports received by the Mission from KRB did not show delinquent loans or the amounts of principal or interest in arrears and thus were not sufficiently informative to provide a basis for Mission control.

As described at page 61, a substantial portion of counterpart funds was allocated for loans to private and public entities for the advancement of Korean industry, agriculture, and housing. The loan program was assigned by CEB for administration by the three government-controlled banks which made individual loans upon approval by CEB. Through December 31, 1960, a total of 112.6 billion hwan had been allocated for loans by the three banks.

| <u>Bank</u>                | <u>Amount</u><br><u>(billions of hwan)</u> |
|----------------------------|--|
| Korean Reconstruction Bank | 81.8                                       |
| Korean Agriculture Bank    | 25.5                                       |
| Bank of Korea              | <u>5.3</u>                                 |
| Total                      | <u>112.6</u>                               |



Of the above amount, about 40 billion hwan was segregated in eight revolving funds authorized by CEB for loans in specific economic areas.

In reviewing the loan records and bank reports of KRB, we noted that many loans were delinquent as to principal and interest. With respect to one revolving fund for short-term operating loans, 25 percent of outstanding loans of 1.2 billion hwan were delinquent. The loan status report of KRB to the Mission for December 1960 indicated that many loans were delinquent but did not identify the loans or the extent of arrears. The Korean Board of Audit reported that at March 31, 1961, outstanding loans of KRB amounted to 164 billion hwan and that principal and interest in the amount of 49.6 billion hwan were in arrears. More than half of the KRB loans were from counterpart funds.

A number of loans on projects in the small and medium industry program greatly exceeded the assets of the project sponsors and were therefore unsound financial risks. These loans are discussed on page 132.

It was not practicable for us to ascertain the extent to which collections of principal and interest were not deposited promptly in the counterpart account. However, in five of seven cases tested, deposits were tardy. In one instance collections made in August 1959 had not been deposited at December 31, 1960; in another, 10 million hwan collected in October 1959 and February 1960 on the sale of equipment, which was applicable to reduction of the loan on the equipment, was not deposited into the counterpart account until January 1961.

Under the CEB authorization, KRB was entitled to retain from collections a service charge of 3 percent a year on the outstanding balance of each loan but only if the loan was current as to principal and interest. However, KRB followed the practice of retaining a proportionate amount of all interest collections for its service charge regardless of whether the respective loans were current. The Mission agreed that this practice was not authorized and stated that, in order to take action to remedy it, a report would be obtained from KRB showing the amounts currently due on loans on which service charges had been improperly taken. We computed the service charges on four of those loans which we reviewed and determined that the excess charges retained by KRB on these four loans amounted to 69.3 million hwan.

KRB retained for its own account penalty interest collected on delinquent loans. Bank officials justified this retention on the grounds that no provision was made by CEB for either collection or disposition of penalty interest and that the service charge was insufficient thereby necessitating retention of penalty

interest as additional revenue to the bank. Mission officials stated that, while the CEB regulation did not specify penalty interest, the regulation was intended to include all interest. Penalty interest on seven loans which we reviewed amounted to 71 million hwan. The Mission informed us that the matter of penalty interest was under discussion with the Korean Government and that an agreement would have to be reached before steps could be taken to have penalty interest deposited into the counterpart account.

#### Proposed action and agency response

In the light of the conditions outlined above and the importance and financial magnitude of the counterpart loan program in the over-all aid picture, we proposed that ICA through the Mission:

1. Resolve with KRB, and the other two banks as may be appropriate, the proper handling of service charges, penalty interest, and timely deposits.
2. Arrange with the three banks to revise the form and content of their reports on counterpart loans so as to provide information necessary to meaningful review by the Mission, and initiate within the Mission an effective system to insure review and follow-up action on such reports.
3. Examine the lending and administrative policies and practices of the three banks and take such steps as may be necessary to effectuate any changes which may be indicated by such examination.
4. Make such audits of individual loans or segments of the operations of the three banks from time to time as circumstances and sound management judgment may dictate to be necessary to round out an effective system of control.

In March 1962, the Agency advised us (1) that the Mission planned to review the several counterpart loan programs and the status of repayments in early 1962, (2) that the organization and function of the KRB were then under review by the Korean Government and the Mission and (3) that a similar review was planned for the loan programs of the other banks, but not, at that time, for the revolving funds because of staffing limitations and lower priority of the revolving funds in relation to dollar and other local currency aid activities.

## SCOPE OF EXAMINATION

Our examination of the economic and technical assistance program for Korea covered the fiscal years 1957 through 1961 and consisted principally of a review of the financial and related administrative practices and procedures followed by ICA in carrying out selected major activities within the over-all program.

We reviewed program documents, reports, correspondence, and other pertinent material available to us at the Washington office of ICA and the agency's overseas Mission in Korea, which we visited during the spring and summer of 1961 and at various later dates, and discussed relevant matters with responsible agency representatives. We also reviewed records of certain agencies of the Korean Government on a limited basis and discussed appropriate matters with representatives of these agencies. In the field we visited selected project sites and reviewed matters relating to projects with responsible technical and administrative personnel of the Mission and of United States contractors.

We examined financial records and transactions to the extent we deemed appropriate in view of the effectiveness of the system of internal control. We had previously made a similar examination of transactions for the fiscal years 1954 through 1956.

## OPINION ON FINANCIAL STATEMENTS

The accompanying financial statements showing the obligation and expenditure of mutual security funds for economic and technical assistance to Korea for the fiscal years 1954 through 1961 are based on fiscal reports and supporting data available at the International Cooperation Administration in Washington, D.C., and its Mission in Korea. We have made certain reclassifications and additional disclosures which we consider necessary for an informative financial presentation.

An undetermined portion of aid funds was used to finance, as nonproject assistance, new and existing enterprises under substantially the same conditions as those for financing of projects. ICA did not maintain its records in such a way as to make it practicable to determine the amount of such financing.

Except as to the above matter, in our opinion the accompanying financial statements present fairly the obligations and expenditures incurred by the International Cooperation Administration for the economic and technical assistance program for Korea during the fiscal years 1954 through 1961.

FINANCIAL STATEMENTS

## INTERNATIONAL COOPERATION ADMINISTRATION

## ASSISTANCE PROGRAM FOR KOREA

## SUMMARY OF OBLIGATIONS AND EXPENDITURES

## BY SOURCE OF FUNDS

FISCAL YEARS 1954-61

| <u>Fiscal year and appropriation</u>                         | <u>Obligations</u> | <u>Expenditures</u> |
|--|--------------------|---------------------|
| 1954-56:   |                    |                     |
| Defense support  | \$ 672,746,365     | \$ 672,746,365      |
| Emergency relief   | 9,000,000          | 9,000,000           |
| Technical cooperation  | 3,233,355          | 3,233,355           |
| Administration (note b)                                      | <u>2,066,552</u>   | <u>2,066,552</u>    |
| Total, 1954-56 (note c)                                      | <u>687,046,272</u> | <u>687,046,272</u>  |
| 1957:  |                    |                     |
| Defense support:   |                    |                     |
| Current year funds (note d)                                  | 223,632,734        | 223,632,734         |
| Prior year funds reprogramed                                 | 23,849,633         | 23,849,633          |
| Consolidation of 1957 and prior year appropriations (note e) | <u>44,634,629</u>  | <u>44,634,629</u>   |
|  | <u>292,116,996</u> | <u>292,116,996</u>  |
| Technical cooperation:                                       |                    |                     |
| Current year funds (note d)                                  | 1,765,982          | 1,765,982           |
| Consolidation of 1957 and prior year appropriations (note e) | <u>2,710,986</u>   | <u>2,710,986</u>    |
|  | 4,476,968          | 4,476,968           |
| Administration (note b)                                      | <u>1,267,410</u>   | <u>1,267,410</u>    |
| Total, 1957  | <u>297,861,374</u> | <u>297,861,374</u>  |
| 1958:  |                    |                     |
| Defense support:   |                    |                     |
| Current year funds (note d)                                  | 180,079,124        | 180,079,124         |
| Prior year funds reprogramed                                 | 8,678,735          | 8,678,735           |
| Consolidation of 1958 and prior year appropriations (note e) | <u>33,199,504</u>  | <u>33,199,504</u>   |
|  | <u>221,957,363</u> | <u>221,957,363</u>  |
| Technical cooperation:                                       |                    |                     |
| Current year funds (note d)                                  | 2,718,858          | 2,718,858           |
| Prior year funds reprogramed                                 | 106,720            | 106,720             |
| Consolidation of 1958 and prior year appropriations (note e) | <u>3,393,279</u>   | <u>3,393,279</u>    |
|  | 6,218,857          | 6,218,857           |
| Administration (note b)                                      | <u>1,388,758</u>   | <u>1,388,758</u>    |
| Total, 1958  | <u>229,564,978</u> | <u>229,564,978</u>  |

INTERNATIONAL COOPERATION ADMINISTRATION  
ASSISTANCE PROGRAM FOR KOREA

SUMMARY OF OBLIGATIONS AND EXPENDITURES  
BY SOURCE OF FUNDS (continued)  
FISCAL YEARS 1954-61

| <u>Fiscal year and appropriation</u>                         | <u>Obligations</u>     | <u>Expenditures</u>    |
|--|------------------------|------------------------|
| 1959:  |                        |                        |
| Defense support:   |                        |                        |
| Current year funds (note d)                                  | \$ 177,261,337         | \$ 177,261,337         |
| Prior year funds reprogramed                                 | 13,190,177             | 13,190,177             |
| Consolidation of 1959 and prior year appropriations (note e) | <u>65,332,843</u>      | <u>29,088,304</u>      |
|  | <u>255,784,357</u>     | <u>219,539,818</u>     |
| Technical cooperation:                                       |                        |                        |
| Current year funds (note d)                                  | 3,175,226              | 3,175,226              |
| Prior year funds reprogramed                                 | 261,207                | 261,207                |
| Consolidation of 1959 and prior year appropriations (note e) | <u>4,061,117</u>       | <u>2,192,580</u>       |
|  | 7,497,550              | 5,629,013              |
| Administration (note b)                                      | <u>1,533,042</u>       | <u>1,533,042</u>       |
| Total, 1959  | <u>264,814,949</u>     | <u>226,701,873</u>     |
| 1960:  |                        |                        |
| Defense support:   |                        |                        |
| Current year funds (notes d and f)                           | 188,579,951            | 172,831,829            |
| Prior year funds reprogramed                                 | <u>19,496,944</u>      | <u>7,401,354</u>       |
|  | <u>208,076,895</u>     | <u>180,233,183</u>     |
| Technical cooperation:                                       |                        |                        |
| Current year funds (note d)                                  | 6,128,878              | 3,440,453              |
| Prior year funds reprogramed                                 | <u>1,782,127</u>       | <u>219,576</u>         |
|  | 7,911,005              | 3,660,029              |
| Administration (note b)                                      | <u>1,671,817</u>       | <u>1,662,997</u>       |
| Total, 1960  | <u>217,659,717</u>     | <u>185,556,209</u>     |
| 1961:  |                        |                        |
| Defense support (note g)                                     | 185,115,012            | 69,949,430             |
| Technical cooperation  | 6,953,380              | 3,726,797              |
| Administration (note b)                                      | <u>1,597,756</u>       | <u>1,338,500</u>       |
| Total, 1961  | <u>193,666,148</u>     | <u>75,014,727</u>      |
| Total, 1954-61   | <u>\$1,890,613,438</u> | <u>\$1,701,745,433</u> |

## INTERNATIONAL COOPERATION ADMINISTRATION

## ASSISTANCE PROGRAM FOR KOREA

## SUMMARY OF OBLIGATIONS AND EXPENDITURES

BY SOURCE OF FUNDS (continued)

FISCAL YEARS 1954-61

## Notes

<sup>a</sup>This schedule and its related schedules (2, 3, and 4) show the activities of ICA and its predecessor, the Foreign Operations Administration, under the mutual security program. The schedules do not include loans by the Development Loan Fund or local currency funds derived from the sale of surplus agricultural commodities under title I of Public Law 480 which were made available for assistance to Korea.

<sup>b</sup>Represents only Mission administrative expenses. The agency does not allocate Washington office expenses to individual country programs.

<sup>c</sup>This amount excludes mutual security funds applied to United Nations Korean Reconstruction Agency (\$42.2 million) and civilian relief activities of the United States military authorities in Korea (\$17.4 million), as shown in our previous audit report for 1954-56. In addition, subsequent deobligations, adjustments, and consolidation of accounts for liquidation purposes (see note e) in the period 1957-61 reduced total obligations from \$832,990,600, as shown in our previous audit report for 1954-56, to \$687,046,272.

<sup>d</sup>Represents obligations incurred during the current year not subsequently deobligated or transferred to consolidation accounts (see note e).

<sup>e</sup>These amounts represent obligations which had not been liquidated at the beginning of the second fiscal year following the year for which the funds were appropriated. As authorized by mutual security appropriation legislation, these obligations were consolidated each fiscal year into a single account for each type of appropriation. Subsequent to consolidation these obligations were liquidated by expenditure, and some obligations may have been deobligated and reobligated. However, it is not practical to identify such transactions by years.

<sup>f</sup>Includes \$17.5 million provided by the special Presidential fund, 1960.

<sup>g</sup>Includes \$20.0 million provided by the special Presidential fund, 1961.

## SUMMARY OF OBLIGATIONS AND EXPENDITURES

## BY TYPE OF AID

FISCAL YEARS 1954-61

|  | <u>Obligations</u> | <u>Expenditures</u> |
|--|--------------------|---------------------|
|  | (in thousands)     |                     |
| COMMODITY IMPORT PROGRAM:                                      |                    |                     |
| Agricultural commodities:                                      |                    |                     |
| Fertilizer and pesticides                                      | \$ 359,526         | \$ 331,479          |
| Raw cotton   | 176,583            | 176,405             |
| Other  | 125,156            | 120,754             |
| Industrial machinery, raw material, and semifinished products: |                    |                     |
| Textile products   | 83,301             | 67,631              |
| Industrial machinery and equipment                             | 74,251             | 65,315              |
| Other  | 266,071            | 232,000             |
| Fuels  | 174,969            | 145,865             |
| Miscellaneous  | <u>82,839</u>      | <u>78,379</u>       |
| Total, commodity imports (schedule 3)                          | <u>1,342,696</u>   | <u>1,217,828</u>    |
| PROJECT ASSISTANCE:  |                    |                     |
| Commodities and contract services (schedule 4)                 | 472,876            | 411,353             |
| U.S. technicians   | 17,462             | 16,762              |
| Technical support  | 8,633              | 8,371               |
| Participant training   | <u>5,583</u>       | <u>4,505</u>        |
| Total, project assistance (note a)                             | <u>504,554</u>     | <u>440,991</u>      |
| OTHER ASSISTANCE.  |                    |                     |
| Cash grant for budget support                                  | 20,000             | 20,000              |
| Overseas administration  | 9,525              | 9,257               |
| Emergency relief and assistance                                | 9,000              | 9,000               |
| Ocean freight for voluntary relief shipments                   | <u>4,838</u>       | <u>4,669</u>        |
| Total, other assistance  | <u>43,363</u>      | <u>42,926</u>       |
| Total, 1954-61   | <u>\$1,890,613</u> | <u>\$1,701,745</u>  |

<sup>a</sup>Includes \$221.3 million recorded by the agency as nonproject assistance but determined by the agency to be project assistance.



INTERNATIONAL COOPERATION ADMINISTRATION  
ASSISTANCE PROGRAM FOR KOREA

SUMMARY OF OBLIGATIONS AND EXPENDITURES  
FOR COMMODITY IMPORT PROGRAM

BY MAJOR CATEGORY OF COMMODITIES, FISCAL YEARS 1954-61  
AT JUNE 30, 1961

| Commodity category   | Obligations    |           |           |           |           |           | Total       | Cumulative expenditures |
|--|----------------|-----------|-----------|-----------|-----------|-----------|-------------|-------------------------|
|  | 1954-56        | 1957      | 1958      | 1959      | 1960      | 1961      |             |                         |
|  | (in thousands) |           |           |           |           |           |             |                         |
| AGRICULTURAL COMMODITIES   |                |           |           |           |           |           |             |                         |
| Fertilizer and pesticides  |                |           |           |           |           |           |             |                         |
| Fertilizer (see p 107)   | \$119,505      | \$ 52,360 | \$ 47,908 | \$ 45,573 | \$ 37,182 | \$ 52 637 | \$ 355,165  | \$ 327,173              |
| Pesticides   | 1,332          | 492       | 615       | 882       | 788       | 252       | 4,361       | 4,306                   |
| Raw cotton (see p 71)  | 71,904         | 11,085    | 29,651    | 26,911    | 30,032    | 7,000     | 176,583     | 176 405                 |
| Grains   |                |           |           |           |           |           |             |                         |
| Bread  | 12,763         | 16,078    | 5,937     | 7,382     | 1,165     | -         | 43,325      | 43 325                  |
| Coarse   | 6,127          | 11,819    | 1,961     | -         | 267       | 6,000     | 26,174      | 25 230                  |
| Wool   | 4,475          | 6,320     | 5,745     | 4,240     | 1,997     | 1,200     | 23,977      | 22,777                  |
| Raw sugar  | 9,253          | 5 994     | 1,980     | -         | -         | -         | 17,227      | 17,227                  |
| Fats and oils  | 4,576          | 1,490     | 1,971     | 1,189     | 2,727     | 2,500     | 14,453      | 12 195                  |
| Total, agricultural commodities                                      | 229,935        | 105,638   | 95 768    | 86,177    | 74,158    | 69,589    | 661,265     | 628,638                 |
| INDUSTRIAL MACHINERY, RAW MATERIAL, AND SEMIFINISHED PRODUCTS        |                |           |           |           |           |           |             |                         |
| Textile products   | 28,007         | 12,992    | 8,314     | 7,239     | 9,814     | 16,935    | 83,301      | 67 631                  |
| Industrial machinery and equipment                                   | 18,852         | 10,117    | 7,772     | 18,326    | 15 496    | 3,688     | 74,251      | 65,315                  |
| Chemicals and chemical preparations                                  | 13,870         | 12,983    | 8,607     | 10,146    | 10,049    | 7,800     | 63,455      | 57,911                  |
| Lumber and sawmill products  | 11 618         | 3,041     | 3,177     | 6,875     | 8,884     | 8,767     | 42,362      | 34,670                  |
| Rubber and rubber products   | 11,918         | 4,691     | 2,214     | 4,980     | 6,796     | 8,530     | 39,129      | 32,475                  |
| Paper, pulp, and paper products                                      | 10,765         | 7,841     | 4,644     | 4,273     | 4,493     | 6 000     | 38,016      | 34,000                  |
| Iron and steel mill products   | 7,041          | 6,145     | 5,145     | 3,857     | 7,572     | 3 912     | 33,672      | 29,034                  |
| Nonmetallic minerals   | 11,106         | 4,052     | 518       | 1,096     | 3,840     | 2,200     | 22,812      | 20,910                  |
| Nonferrous metals  | 2,647          | 3,688     | 1,976     | 2,080     | 2,560     | 3,955     | 16 906      | 13,999                  |
| Vegetable fibers   | 1,704          | 515       | 400       | 870       | 5,230     | 1,000     | 9,719       | 9,001                   |
| Total, industrial machinery, raw material, and semifinished products | 117 528        | 66,065    | 42,767    | 59,742    | 74,734    | 62 787    | 423,623     | 364 946                 |
| FUELS  |                |           |           |           |           |           |             |                         |
| Oil and petroleum products   | 46,101         | 18,852    | 18,172    | 21,872    | 24,922    | 22,677    | 152,596     | 124 005                 |
| Coal and related fuels   | 5,504          | 2,275     | 9,415     | 3,580     | 1 099     | 500       | 22,373      | 21 860                  |
| Total fuels  | 51,605         | 21,127    | 27,587    | 25,452    | 26 021    | 23,177    | 174,969     | 145,865                 |
| MISCELLANEOUS  |                |           |           |           |           |           |             |                         |
| Medical and pharmaceutical preparations                              | 6,335          | 4,378     | 2,920     | 2,894     | 2,695     | 2,500     | 21,722      | 19,428                  |
| Triangular trade   | 3,457          | -         | 5,319     | 6,902     | 5 833     | 1,500     | 23,011      | 21,979                  |
| Other  | 16,240         | 12,841    | 2,416     | 3,122     | 3,042     | 445       | 38,106      | 36,972                  |
| Total, miscellaneous   | 26,032         | 17,219    | 10,655    | 12,918    | 11,570    | 4,445     | 82,839      | 78,379                  |
| Total, commodity import program                                      | \$425,100      | \$210,049 | \$176,777 | \$184,289 | \$186,483 | \$159,998 | \$1,342,696 | \$1,217,828             |

INTERNATIONAL COOPERATION ADMINISTRATION

ASSISTANCE PROGRAM FOR KOREA

STATUS OF OBLIGATIONS FOR PROJECT ASSISTANCE

FOR COMMODITIES AND CONTRACT SERVICES

BY FIELD OF ACTIVITY AND MAJOR PROJECT, FISCAL YEARS 1954-61

AT JUNE 30, 1961

| Field of activity and<br>major project<br>( <u>note a</u> )                            | Obliga-<br>tions | Expend-<br>itures |
|--|------------------|-------------------|
|  | (in thousands)   |                   |
| TRANSPORTATION:  |                  |                   |
| Korean national railroad logistic support<br>(note b)                                  | \$ 94,590        | \$ 94,581         |
| Railway rolling stock  | 18,854           | 18,393            |
| Diesel locomotives   | 17,023           | 17,022            |
| Highway and bridge construction and rehabil-<br>itation                                | 15,691           | 12,480            |
| Railway construction   | 10,049           | 9,941             |
| Railway rehabilitation   | 7,560            | 7,556             |
| Cargo vessels  | 6,548            | 6,548             |
| Port and harbour improvement   | 5,248            | 4,651             |
| Civil aviation operations improvement  | 1,510            | 588               |
| Inchon port rehabilitation   | 1,405            | 705               |
| Streetcar rehabilitation   | 1,273            | 1,273             |
| Other  | 3,747            | 3,375             |
| Total, transportation  | <u>183,498</u>   | <u>177,113</u>    |
| INDUSTRY AND MINING:   |                  |                   |
| Chung-Ju fertilizer plant (note c and see<br>p. 47)                                    | 40,509           | 36,771            |
| Thermal power plants (at Masan, Tangin-Ri,<br>and Samchock, see p. 45)                 | 28,416           | 28,416            |
| Rehabilitation and reconstruction of over-<br>all transmission and distribution system | 9,794            | 4,994             |
| Thermal power plant (at Kunsan, see p. 123)  | 9,750            | 35                |
| Rehabilitation Hwachon power plant (see<br>p. 46)                                      | 9,485            | 9,485             |
| Medium industry development (fiscal years<br>1957-61, see p. 128)                      | 9,111            | 4,822             |
| Coal mine development  | 6,178            | 3,803             |
| Rehabilitation of Chong Pyong Dam (see<br>p. 122)                                      | 6,000            | 12                |

INTERNATIONAL COOPERATION ADMINISTRATION

ASSISTANCE PROGRAM FOR KOREA

STATUS OF OBLIGATIONS FOR PROJECT ASSISTANCE

FOR COMMODITIES AND CONTRACT SERVICES

BY FIELD OF ACTIVITY AND MAJOR PROJECT, FISCAL YEARS 1954-61  
(continued)

AT JUNE 30, 1961

| Field of activity and<br>major project<br>( <u>note a</u> )      | Obliga-<br><u>tions</u> | Expend-<br><u>itures</u> |
|--|-------------------------|--------------------------|
|  | (in thousands)          |                          |
| INDUSTRY AND MINING: (continued)                                 |                         |                          |
| Rehabilitation of Yongwol and Tangin-Ri<br>power plants          | \$ 5,930                | \$ 1,216                 |
| Development of metals and minerals (other<br>than coal)          | 3,983                   | 1,862                    |
| Small industry development (fiscal years<br>1957-61, see p. 128) | 3,941                   | 3,804                    |
| Seoul central exchange (see p. 46)                               | 2,844                   | 2,763                    |
| Telecommunication, inside plant equipment<br>(see p. 46)         | 2,167                   | 2,167                    |
| Pusan Iron Works (see p. 144)                                    | 1,995                   | 1,995                    |
| Waterworks rehabilitation and expansion                          | 1,883                   | 9                        |
| Telecommunication cable and open wire lines<br>(see p. 46)       | 1,626                   | 1,539                    |
| Seoul telephone cable (see p. 46)                                | 1,488                   | 1,488                    |
| Extension of telecommunication system (see<br>p. 46)             | 1,360                   | 1,334                    |
| Spun rayon plant   | 1,000                   | 1,000                    |
| Other (note d)   | <u>27,501</u>           | <u>26,088</u>            |
| Total, industry and mining                                       | <u>174,961</u>          | <u>133,603</u>           |
| AGRICULTURE AND NATURAL RESOURCES:                               |                         |                          |
| Irrigation   | 7,850                   | 7,850                    |
| Fisheries development  | 4,574                   | 3,857                    |
| Rural warehouses   | 3,009                   | 3,009                    |
| Land and water use improvement                                   | 2,853                   | 2,797                    |
| Flood control  | 2,185                   | 2,180                    |
| Agricultural extension development                               | 1,202                   | 1,104                    |
| Other  | <u>5,946</u>            | <u>5,805</u>             |
| Total, agriculture and natural resources                         | <u>27,619</u>           | <u>26,602</u>            |

INTERNATIONAL COOPERATION ADMINISTRATION  
ASSISTANCE PROGRAM FOR KOREA

STATUS OF OBLIGATIONS FOR PROJECT ASSISTANCE  
FOR COMMODITIES AND CONTRACT SERVICES

BY FIELD OF ACTIVITY AND MAJOR PROJECT, FISCAL YEARS 1954-61  
(continued)

AT JUNE 30, 1961

| Field of activity and<br>major project<br>( <u>note a</u> ) | Obliga-<br>tions | Expend-<br>itures |
|---|------------------|-------------------|
|   | (in thousands)   |                   |
| <b>EDUCATION:</b>   |                  |                   |
| Higher education (see p. 140)                               | \$ 9,379         | \$ 7,864          |
| Improvement teacher training                                | 3,667            | 2,648             |
| Classroom construction                                      | 2,580            | 2,287             |
| Secondary education (see p. 150)                            | 1,841            | 1,661             |
| Other   | 695              | 648               |
| Total, education  | <u>18,162</u>    | <u>15,108</u>     |
| <b>COMMUNITY DEVELOPMENT:</b>                               |                  |                   |
| Housing finance, construction, and planning<br>(see p. 134) | 5,199            | 3,989             |
| Refugee economic assimilation                               | 2,579            | 2,433             |
| Republic of Korea office building (see<br>p. 52)            | 2,183            | 1,323             |
| Public health relief  | 1,584            | 1,584             |
| Mission office building (see p. 52)                         | 1,549            | 927               |
| Other   | 4,815            | 4,199             |
| Total, community development                                | <u>17,909</u>    | <u>14,455</u>     |
| <b>HEALTH AND SANITATION:</b>                               |                  |                   |
| Waterworks rehabilitation (see p. 47)                       | 8,401            | 8,372             |
| Public health facilities improvement (see<br>p. 139)        | 2,192            | 2,189             |
| Street and city drainage (see p. 47)                        | 2,155            | 2,155             |
| Disease control   | 2,139            | 1,967             |
| Environmental sanitation                                    | 1,846            | 1,744             |
| Other   | 447              | 240               |
| Total, health and sanitation                                | <u>17,180</u>    | <u>16,667</u>     |

INTERNATIONAL COOPERATION ADMINISTRATION

ASSISTANCE PROGRAM FOR KOREA

STATUS OF OBLIGATIONS FOR PROJECT ASSISTANCE

FOR COMMODITIES AND CONTRACT SERVICES

BY FIELD OF ACTIVITY AND MAJOR PROJECT, FISCAL YEARS 1954-61  
(continued)

AT JUNE 30, 1961

| Field of activity and<br>major project<br>( <u>note a</u> )   | Obliga-<br>tions | Expend-<br>itures |
|---|------------------|-------------------|
|   | (in thousands)   |                   |
| PUBLIC ADMINISTRATION:  |                  |                   |
| Improvement of government fiscal management<br>and statistics | \$ 1,951         | \$ 710            |
| National police modernization                                 | 1,673            | 1,402             |
| Other   | <u>1,820</u>     | <u>888</u>        |
| Total, public administration                                  | <u>5,444</u>     | <u>3,000</u>      |
| GENERAL AND MISCELLANEOUS.                                    |                  |                   |
| Military surplus  | 21,407           | 21,407            |
| General engineering services (see p. 52)                      | 4,236            | 2,232             |
| Other   | <u>2,460</u>     | <u>1,166</u>      |
| Total, general and miscellaneous                              | <u>28,103</u>    | <u>24,805</u>     |
| Total, project assistance                                     | <u>\$472,876</u> | <u>\$411,353</u>  |

<sup>a</sup>Includes all projects with obligations of \$1 million or more at June 30, 1961.

<sup>b</sup>This project was initiated in fiscal year 1954, and aid financing consisted of \$51 million for coal and \$43.6 million for maintenance, rehabilitation, and operating materials and equipment required for continued operation of the railroad system. Since fiscal year 1958, coal and other supplies have been financed as non-project assistance under the commodity import program.

<sup>c</sup>The amounts include obligations and expenditures of \$5,254,000 and \$2,909,000, respectively, for a management and training contract. The obligations and expenditures for plant construction were \$35,255,000 and \$33,862,000, respectively.

<sup>d</sup>Includes small and medium industry development prior to fiscal year 1957--approximately \$16 million. These projects were recorded by the agency as nonproject assistance under the accounting system then in effect.

APPENDIX

OFFICIALS RESPONSIBLE FOR ADMINISTRATION  
OF THE ECONOMIC AND TECHNICAL ASSISTANCE PROGRAM  
FOR KOREA  
STARTING WITH FISCAL YEAR 1957

|   | <u>Appointed or<br/>commissioned*</u> |
|---|---------------------------------------|
| <b>SECRETARY OF STATE:</b>  |                                       |
| John Foster Dulles  | Jan. 21, 1953                         |
| Christian A. Herter   | Apr. 22, 1959                         |
| Dean Rusk   | Jan. 21, 1961                         |
| <b>UNDER SECRETARY OF STATE (note a):</b>   |                                       |
| C. Douglas Dillon   | Feb 3, 1959                           |
| George W. Ball  | Feb 2, 1961                           |
| <b>DIRECTOR, INTERNATIONAL COOPERATION ADMINISTRATION (formerly Foreign Operations Administration):</b> |                                       |
| John B. Hollister   | July 1, 1955                          |
| James H. Smith, Jr.   | Oct. 4, 1957                          |
| James W. Riddleberger   | Mar. 9, 1959                          |
| Henry R. Labouisse (note b)   | Feb. 22, 1961                         |
| <b>COMMANDER IN CHIEF, UNITED NATIONS COMMAND (note c):</b>   |                                       |
| Lyman L. Lemnitzer  | June 1955                             |
| George H. Decker  | July 1, 1957                          |
| <b>AMBASSADOR TO KOREA (note c):</b>  |                                       |
| Walter C. Dowling   | July 14, 1956                         |
| Walter P. McConaughy  | Dec. 18, 1959                         |
| Samuel D. Berger  | June 27, 1961                         |
| <b>DIRECTOR, U.S. OPERATIONS MISSION TO KOREA (notes c and d):</b>                                      |                                       |
| William E. Warne  | June 26, 1956                         |
| Raymond T. Moyer  | Aug 20, 1959                          |
| James S. Killen   | Sept. 19, 1961                        |

\*In the case of Ambassadors, date of presentation of credentials

<sup>a</sup>On February 3, 1959, the Secretary of State placed the International Cooperation Administration under the direction and control of the Under Secretary of State for Economic Affairs, Mr. C. Douglas Dillon. On June 12, 1959, this responsibility,

(continued on next page)

OFFICIALS RESPONSIBLE FOR ADMINISTRATION  
OF THE ECONOMIC AND TECHNICAL ASSISTANCE PROGRAM  
FOR KOREA (continued)

STARTING WITH FISCAL YEAR 1957

together with the over-all direction and coordination of the mutual security program, was reassigned to Mr. Dillon as Under Secretary of State. On February 2, 1961, Mr. George W. Ball was confirmed as Under Secretary of State for Economic Affairs and assumed the responsibilities for the mutual security program formerly carried out by Mr. Dillon.

<sup>b</sup>Mr. Henry R. Labouisse remained Director, International Cooperation Administration, until the agency terminated on November 3, 1961. Mr. Fowler Hamilton was named Administrator of the successor agency, Agency for International Development, September 23, 1961.

<sup>c</sup>Prior to July 1, 1959, the field organization that administered the program in Korea was under the over-all jurisdiction of the Commander in Chief, the United Nations Command (CINCUNC) and was officially designated as the Office of the Economic Coordinator (OEC). This was due to the fact that the CINCUNC was assigned responsibility for the entire aid program in Korea under the Presidential Memorandum of August 7, 1953, and the head of the OEC was designated the senior economic staff member of the CINCUNC. On July 1, 1959, responsibility for policy coordination of the aid program in Korea was transferred to the American Ambassador, and the Mission was separated from the United Nations Command and established as an independent operating mission.

<sup>d</sup>With the approval of the administration in January 1962, the United States Aid Mission to Korea is still known officially there as United States Operations Mission to Korea.